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Fact Sheet for the Chairman, Subcommittee on Public Lands, Committee on Interior and Insular Affairs, House of Representatives

August 1986

TAX POLICY AND ADMINISTRATION

Historic Preservation Tax Incentives

RELEASED

GAO United States
General Accounting Office
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General Government Division

B-214148

August 1, 1986

The Honorable John F. Seiberling
Chairman, Subcommittee on Public Lands
Committee on Interior and Insular Affairs
House of Representatives

Dear Mr. Chairman:

On August 29, 1985, you asked us to provide the most recent information available on nationwide historic preservation activities as an update of our earlier report, Information on Historic Preservation Tax Incentives (GAO/GGD-84-47, Mar. 29, 1984). We recently briefed your representative on the status of our work and, at her request, we are issuing our briefing package as a formal document consisting of four appendixes.

We obtained and analyzed Internal Revenue Service (IRS) statistics on qualified rehabilitation expenditures for tax years 1982 and 1983--the only years for which this information is available--and National Park Service (NPS) statistics for fiscal years 1977 through 1985 on activities associated with the rehabilitation of certified historic structures. Also, since the National Trust for Historic Preservation provided various analyses of its data on the rehabilitation of certified historic structures in 1977 through 1985, we separately provided this information to your staff without further analysis. A more detailed discussion of the scope and methodology of our work is presented in appendix I.

Appendix II contains our analyses of IRS' Statistics of Income data on qualified rehabilitation expenditures reported by taxpayers in 1982 and 1983. These analyses indicate that during tax years 1982 and 1983, individual and corporate taxpayers reported about $6.1 billion in qualified rehabilitation expenditures--$2.55 billion in 1982, and $3.55 billion in 1983. About 54 percent of the 2-year total expenditures were for the rehabilitation of 40-year old buildings and about 36 percent for certified historic structures. A $655 million increase in expenditures reported for the rehabilitation of certified historic structures accounted for about two-thirds of the total increase ($996.5 million) in expenditures from 1982 to 1983. We estimate that individuals and corporations earned $1.3 billion in tax credits on the expenditures reported during this 2-year period. Individual taxpayers earned $893.8 million, or 69 percent, of these credits while corporations earned $409.5 million, or 31 percent.

IRS' Statistics of Income information indicates that individual taxpayers with adjusted gross incomes of $100,000 or more reported more than one-half of the total expenditures reported by individuals in 1982 and 1983. Most of these expenditures involved the rehabilitation of certified historic structures and 40-year old buildings.

Appendix III contains a discussion of (1) the roles of NPS and state preservation officers and (2) our analyses of NPS statistics on certified historic structure activities involving NPS during fiscal years 1977 through 1985.

In comparing statistics on the number of applications received, approved plans, estimated expenditures, and certified rehabilitations before and after the Economic Recovery Tax Act (ERTA), we noted major increases in the levels of these activities since ERTA. During fiscal years 1982 through 1985, the NPS received about four times the number of applications it received during fiscal years 1977 through 1981. The number of planned rehabilitations NPS approved since ERTA more than tripled the number approved during earlier years. Estimated expenditures for post-ERTA approved projects were over five times the expenditures estimated for approved projects during the pre-ERTA years. Since ERTA, the NPS designated as certified rehabilitations more than three and one-half times the number designated during the 5-year period prior to ERTA.

Appendix IV contains a summary of IRS' efforts to assure taxpayer compliance with tax provisions on the investment tax credits for qualified historic expenditures and on the charitable deduction for donated facade easements.

IRS and NPS officials reviewed a draft of this document and we considered their comments in preparing the final product. As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this document until 15 days from its issue date. At that time, we will send copies to the Department of the Treasury, Internal Revenue Service, and the Department of the Interior. In addition, we will make copies available to other interested parties upon request.

If you have questions about our study or this document, please contact me on 275-6407.

Sincerely yours,

Johnny C. Finch

Johnny C. Finch
Senior Associate Director

C O N T E N T S

FIGURES

ABBREVIATIONS

ERTA	Economic Recovery Tax Act of 1981
GAO	General Accounting Office
IRS	Internal Revenue Service
NPS	National Park Service

OVERVIEW OF THE HISTORIC TAX INCENTIVES PROGRAM

We reported on historic preservation activities during 1976-79.[1] We found that the tax incentives were effective in stimulating investments in historic preservation and foregone federal tax revenues were small in comparison to the dollars invested to restore historic structures. We also noted that complex provisions in the then-existing laws providing for the tax incentives created difficulties for the IRS and the taxpayers.

The Economic Recovery Tax Act of 1981 (ERTA) (Public Law 97-34) provided new incentives for private sector investments in historic preservation and repealed several tax provisions that governed the available tax incentives for these investments. ERTA established new tax credits for qualified rehabilitation expenditures at (1) 25 percent for certified historic structures, regardless of the age of the structure; (2) 20 percent for 40-year old buildings; and (3) 15 percent for 30-year old buildings. Replacing several complex tax options with these three tier flat rates, ERTA reduced the number of options the taxpayers could use to realize the available tax incentives. In doing so, the act also resolved some of the difficulties the Internal Revenue Service (IRS) encountered in ensuring taxpayer compliance with provisions related to historic preservation.

The Senate's tax reform bill (H.R. 3838, as amended) includes a provision to reduce the current tax credits on qualified rehabilitation expenditures to 20 percent for certified historic structures and 10 percent for all non-certified structures.

TAX INCENTIVES FOR HISTORIC PRESERVATION

Under IRS-proposed regulations currently used by IRS, to qualify for the 25 percent tax credit available on certified historic structure expenditures, the taxpayer's property must be (1) designated by the Secretary of the Interior as a certified historic structure and listed in the National Register of Historic Places or (2) located in a registered historic district and certified by the National Park Service (NPS). The structure must be substantially rehabilitated and restoration work, upon completion, must be approved by NPS in accordance with the Secretary of the Interior's standards for rehabilitation. Certified historic structures may be relocated prior to rehabilitation and may also be used for residential or nonresidential purposes.

To qualify for the 20- and 15-percent tax credits available on the restoration of 40-year old and 30-year old buildings, respectively, the taxpayer's rehabilitated property must (1) be

[1]Information on Historic Preservation Tax Incentives (GAO/GGD-84-47, Mar. 29, 1984).

used for nonresidential purposes and (2) have been at the location where it is being rehabilitated for at least 40 or 30 years. The Internal Revenue Code restricts the available tax credits on the restoration of these buildings to depreciable property used for the production of income.

The investment tax credit is available for qualified rehabilitation expenditures. These expenditures include any restoration costs incurred after 1981 that must be capitalized rather than expensed for property that is 18-year recovery property, or 15-year recovery property used for low-income housing. As with other regular investment tax credits, the credit earned on qualified rehabilitation expenditures is limited by the owner's tax liability. The tax credit ceiling for qualified rehabilitation expenditures made on or after January 1, 1982, was $25,000 plus 90 percent of the excess tax liability. For expenditures made on or after January 1, 1983, the limit is $25,000 plus 85 percent of the excess. A credit that cannot be used in the year it arises may be carried back 3 years or carried forward for 15 years.

Under Section 170 of the Internal Revenue Code, a taxpayer may claim as a charitable contribution the fair market value of a historic facade easement donated to qualified charitable organizations. To qualify as a charitable deduction, the donation must be for conservation purposes. Once donated, further changes to the facade are restricted by local, state, or federal rehabilitation standards applicable to the historic district in which the property is located.

ADMINISTRATION OF THE TAX INCENTIVES

NPS and IRS are responsible for administering the historic preservation provisions. The Secretary of the Interior through NPS (1) certifies the historical significance of structures and districts, (2) approves proposed plans for the rehabilitation of certified historic structures, and (3) certifies that the completed rehabilitation of these structures meets Interior-established criteria. IRS is responsible for assuring that taxpayers comply with tax provisions relating to the (1) allowable tax credits on expenditures for the rehabilitation of certified historic structures and of 40- and 30-year old buildings and (2) charitable contribution deductions allowed for the fair market value of donated historic structure facades. NPS provides IRS with information to identify taxpayers who are eligible for the tax credit on certified historic structures.

OBJECTIVE, SCOPE, AND METHODOLOGY

The Subcommittee on Public Lands, House Committee on Interior and Insular Affairs, requested that we update the information contained in our 1984 report on the historic preservation program. Specifically, the Subcommittee asked that we

--provide information on the roles of the Department of the Interior and state historic preservation officers,

--analyze information available at NPS and the National Trust for Historic Preservation,

--provide information on tax provisions, other than the investment tax credit, which may be affecting historic preservation.

To achieve our objective we (1) reviewed applicable laws, regulations, policies, and procedures pertaining to historic preservation activities and to federal and state agencies' roles and responsibilities; (2) obtained and analyzed NPS statistics provided by NPS on activities associated with the rehabilitation of certified historic structures during fiscal years 1977 through 1985; (3) obtained and analyzed IRS data on taxpayers' reported rehabilitation expenditures for certified historic structures, 40-year old buildings, and 30-year old buildings for tax years 1982 and 1983--the only years for which this data are available; (4) reviewed the National Trust for Historic Preservation (National Trust) data on certified historic project activities for fiscal years 1977 through 1985; (5) interviewed IRS, National Trust, and NPS officials at headquarters and IRS officials at the Mid-Atlantic Regional Office, and (6) reviewed other pertinent IRS, NPS, and National Trust reports. We conducted our review during a 6-month period from October 1985 through March 1986.

IRS data compiled by the Statistics of Income Division are estimates based on stratified probability samples of income tax returns and other forms filed with IRS. These estimates are weighted and projectable to returns filed nationwide.

REHABILITATION EXPENDITURES AND ESTIMATED TAX CREDITS FOR TAX YEARS 1982 AND 1983

IRS' projections of data on sampled tax returns showed that individuals and corporations reported about $6.1 billion in qualified rehabilitation expenditures during tax years 1982 and 1983. We estimated that these expenditures earned taxpayers about $1.3 billion in tax credits to reduce their tax liabilities. Taxpayers reported these expenditures for the rehabilitation of certified historic structures as well as for 40- and 30-year old buildings. About 54 percent of the expenditures reported were for the restoration of 40-year old buildings and 36 percent for the rehabilitation of certified historic structures. Individual taxpayers with adjusted gross incomes of $100,000 or more claimed over one-half of the total expenditures reported by individuals.

Partnerships reported about $2.7 billion in qualified rehabilitation expenditures for tax years 1982 and 1983. Rehabilitation expenditures and credits claimed by such partners are reported on their tax returns. Accordingly, the partnership data we present should be considered as part of, not in addition to, the individual and corporate return data.

INDIVIDUAL AND CORPORATION EXPENDITURES

Table II.1 shows that of the $6,110.3 million individuals and corporations claimed as qualified rehabilitation expenditures for tax years 1983 and 1982, $3,553.4 million was claimed in 1983 and $2,556.9 million was claimed in 1982. Our analyses of this data show that taxpayers reported $2,225.6 million, or about 36 percent of the 2-year total, as expenditures for the rehabilitation of certified historic structures. They reported $3,287.9 million, or about 54 percent, for the restoration of 40-year old buildings; and $596.8 million, or about 10 percent, for 30-year old buildings.

Table II.1: Individual and Corporation Rehabilitation Expenditures for Tax Years 1982 and 1983 ($ in millions)

	1982		1983		Total (1982 and 1983)	
	Expenditures[a]	Percent of subtotal	Expenditures[a]	Percent of subtotal	Expenditures[a]	Percent of subtotal
Certified historic structures						
Individuals	$ 635.6	80.9	$1,201.1	83.4	$1,836.7	82.5
Corporations	149.8	19.1	239.1	16.6	388.9	17.5
Subtotals	785.4	100.0	1,440.2	100.0	2,225.6	100.0
40-year buildings						
Individuals	844.2	56.3	1,177.1	65.8	2,021.3	61.5
Corporations	655.6	43.7	611.0	34.2	1,266.6	38.5
Subtotals	1,499.8	100.0	1,788.1	100.0	3,287.9	100.0
30-year buildings						
Individuals	90.2	33.2	112.9	34.7	203.1	34.0
Corporations	181.5	66.8	212.2	65.3	393.7	66.0
Subtotals	271.7	100.0	325.1	100.0	596.8	100.0
Totals	$2,556.9		$3,553.4		$6,110.3	

[a]Statistics of Income, 1983 and 1982 individual and corporation return statistics.

APPENDIX II

Total expenditures in 1983 increased by $996.5 million, or about 39 percent, over the expenditures taxpayers reported for 1982. The increase of $655 million in expenditures for the restoration of certified historic structures accounted for most, or about 66 percent, of the total increase. Except for corporations' rehabilitation of 40-year old buildings, the data show increases in 1983 for each category of rehabilitation and for each of the two types of returns filed.

ESTIMATED TAX CREDITS EARNED BY INDIVIDUALS AND CORPORATIONS

We estimated that individuals and corporations earned $1,303.3 million in tax credits on their reported 1983 and 1982 qualified rehabilitation expenditures. The $766.4 million earned in 1983 represents about a 43-percent increase over the $536.9 million earned in 1982. Table II.2 shows that, for the 2 years, taxpayers earned estimated tax credits of $556.4 million on the rehabilitation of certified historic structures, $657.5 million on 40-year old buildings; and $89.4 million on 30-year old buildings.

Table II.2: Estimated Tax Credits on Individual and Corporation Rehabilitation Expenditures for Tax Years 1982 and 1983
($ in millions)

	Tax year 1982		Tax year 1983		1983 and 1982 totals	
	Tax credits[a]	Percent of subtotals	Tax credits[a]	Percent of subtotals	Tax credits[a]	Percent of subtotals
Certified historic structures						
Individuals	$158.9	80.9	$ 300.3	83.4	$ 459.2	82.5
Corporations	37.4	19.1	59.8[b]	16.6	97.2	17.5
Subtotals	196.3	100.0	360.1	100.0	556.4	100.0
40-year buildings						
Individuals	168.8	56.3	235.4	65.8	404.2	61.5
Corporations	131.1	43.7	122.2	34.2	253.3	38.5
Subtotals	299.9	100.0	357.6	100.0	657.5	100.0
30-year buildings						
Individuals	13.5	33.2	16.9	34.7	30.4	34.0
Corporations	27.2	66.8	31.8[b]	65.3	59.0	66.0
Subtotals	40.7	100.0	48.7	100.0	89.4	100.0
Totals	$536.9		$766.4		$1,303.3	

[a]We computed the maximum estimated tax credits on qualified rehabilitation expenditures for certified historic structures, 40-year old buildings, and 30-year old buildings at 25, 20, and 15 percent, respectively.

[b]Corporation data for tax year 1983 are preliminary and subject to change.

APPENDIX II

Table II.2 also shows that, except for the rehabilitation of 30-year old buildings, individuals earned proportionately greater shares of the credits than corporations. Corporations earned $59.0 million, or 66 percent, of the total credits for the rehabilitation of 30-year old buildings. Individuals earned $459 million, or 82.5 percent of the total credits for certified historic structures and $404.2 million, or 61.5 percent of the tax credits for 40-year old buildings.

Data on the rehabilitation tax credits actually claimed by taxpayers in 1983 and 1982 are not available for several reasons. First, taxpayers may combine these earned credits with other tax credits when reporting their current year investment tax credits. Second, in 1982, investment tax credits were capped at $25,000 plus 90 percent of the excess tax liability which may preclude the taxpayer from claiming the total credits in 1 year. For 1983 qualified expenditures, the investment tax credit cap was lowered slightly to $25,000 plus 85 percent of the excess tax liability. Third, unused investment tax credits reported in a given year may be carried back 3 years or forward 15 years to offset tax liabilities of other tax years.

We based our estimates on qualified rehabilitation expenditures reported in 1982 and 1983 without factoring in adjustments for the 3-year carryback and the 15-year carryforward provisions on these investment tax credits. Our estimates, therefore, reflect the tax credits and potential revenue foregone as a result of qualified rehabilitation expenditures during 1983 and 1982 rather than the credits taxpayers actually claimed to reduce their tax liabilities in the 2 years.

Comparison of 1983 and 1982 estimated tax credits

We estimated that tax credits earned on qualified historic rehabilitation expenditures increased by 43 percent to $766.4 million in 1983 from $536.9 million in 1982. Table II.3 shows the changes by type of property and returns filed.

Table II.3: Increase in 1983 Estimated Tax Credits on Qualified Rehabilitation Expenditures
($ in millions)

	Tax credits 1982	Tax credits 1983	Amount of change	Percentage change
Certified				
Individuals	$158.9	$300.3	$141.4	89
Corporations	37.4	59.8[a]	22.4	60
Subtotals	196.3	360.1	163.8	83
40-year buildings				
Individuals	168.8	235.4	66.6	39
Corporations	131.1	122.2[a]	(8.9)	(7)
Subtotals	299.9	357.6	57.7	19
30-year buildings				
Individuals	13.5	16.9	3.4	25
Corporations	27.2	31.8[a]	4.6	17
Subtotals	40.7	48.7	8.0	20
Totals	$536.9	$766.4	$ 229.5	43

[a]Computation based on preliminary IRS corporation return data which are subject to change.

Of the three types of projects, the rehabilitation of certified historic structures showed the largest dollar increase in estimated tax credits. In this category, taxpayers earned $360.1 million in tax credits in 1983 as compared to $196.3 million earned the previous year. The $163.8 million difference represents an 83-percent increase over the 1982 estimated tax credits. The $141.4 million increase in estimated tax credits earned by individuals accounted for most, or about 89 percent, of the total increase in tax credits earned on the rehabilitation of certified structures. The lowest amount earned for the three types of rehabilitation projects was $48.7 million estimated tax credits earned in 1983 on the rehabilitation of 30-year old buildings.

Of the total $1,303.3 million in estimated tax credits earned in 1983 and 1982, individuals earned 69 percent and corporations earned 31 percent. The estimated credits individuals earned in 1983 rose by $211.4 million, or 61 percent, to $552.6 million. Table II.4 shows the amount earned for each year by type of return filed.

Table II.4: Estimated Tax Credits Earned by Type of Return for Tax Years 1982 and 1983
($ in millions)

	Tax year 1982		Tax year 1983		Total 1983 and 1982	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
Individuals	$341.2	64	$552.6	72	$ 893.8	69
Corporations	195.7	36	213.8[a]	28	409.5	31
Totals	$536.9	100	$766.4	100	$1,303.3	100

[a]Based on preliminary IRS corporation data which are subject to change.

Table II.5 shows that individual taxpayers filed about 90 percent of the total tax returns with reported qualified rehabilitation expenditures in 1982 and 1983. The percentage of returns by types of filers generally remained the same for 1983 and 1982. The total number of returns filed in 1983 decreased by about 3,400 from the total returns filed in 1982.

Table II.5: Returns Filed with Rehabilitation Expenditures Reported for Tax Years 1982 and 1983

	1982 returns		1983 returns	
	Number[a]	Percent	Number[a]	Percent
Individuals	67,734	89.3	65,442	90.4
Corporations[b]	4,596	6.1	4,821	6.7
Partnerships	3,497	4.6	2,172	3.0
Totals	75,827	100.0	72,435	100.0[c]

[a]Statistics of Income; individual, partnership and corporation income tax return data for 1982 and 1983.

[b]1983 corporation return data are preliminary and subject to change. Also, corporation data represent the number of projects rather than returns filed.

[c]Total does not add due to rounding.

INDIVIDUAL TAXPAYER REHABILITATION EXPENDITURES

Individual taxpayers reported $2,491.3 million for 1983 and $1,569.8 million for 1982 as qualified rehabilitation expenditures for the three types of property. This represents an increase of $921.5 million, or about 59 percent from 1982 to 1983. As shown in table II.6, most of the total expenditures were associated with the costs of rehabilitating 40-year old buildings and certified historic structures.

Table II.6: Individual Taxpayers' Reported Rehabilitation Expenditures by Type of Property and by Adjusted Gross Income for Tax Years 1982 and 1983
($ in millions)

	1982 expenditures		1983 expenditures	
	Dollars	Percent	Dollars	Percent
Certified historic structures				
Less than $20,000	$ 24.2	3.8	$ 60.1	5.0
$20,000 to $39,999	63.4	10.0	38.7	3.2
$40,000 to $99,999	81.5	12.8	228.8	19.1
$100,000 or more	466.4	73.4	873.6	72.7
Subtotals	635.5	100.0	1,201.2	100.0
40-year old buildings				
Less than $20,000	167.0	19.8	75.7	6.4
$20,000 to $39,999	89.9	10.6	212.3	18.0
$40,000 to $99,000	171.6	20.3	334.2	28.4
$100,000 or more	415.7	49.2	555.0	47.2
Subtotals	844.2	100.0[a]	1,177.2	100.0
30-year old buildings				
Less than $20,000	22.3	24.7	21.9	19.4
$20,000 to $39,999	3.4	3.8	.6	.5
$40,000 to $99,999	29.8	33.1	33.2	29.4
$100,000 or more	34.6	38.4	57.2	50.7
Subtotals	90.1	100.0	112.9	100.0
Totals	$1,569.8		$2,491.3	

[a]Subtotal does not add due to rounding.

Table II.7 shows that about 60 percent of the individuals' expenditures were reported by taxpayers with adjusted gross incomes of $100,000 or more.

Table II.7: Individual Taxpayers' Reported Rehabilitation Expenditures Based on Adjusted Gross Income for Tax Years 1982 and 1983
($ in millions)

Adjusted gross income	1982 expenditures		1983 expenditures		Change	
	Dollars	Percent	Dollars	Percent	Amount	Percent
Less than $20,000	$ 213.5	13.6	$ 157.7	6.3	$ (55.8)	(6.1)
$20,000 to $39,999	156.7	10.0	251.6	10.1	94.9	10.3
$40,000 to $99,999	282.9	18.0	596.2	23.9	313.3	34.0
$100,000 or more	916.7	58.4	1,485.8	59.6	569.1	61.8
Totals	$1,569.8	100.0	$2,491.3	100.0[a]	$921.5	100.0

[a]Total does not add due to rounding.

Individual taxpayers with adjusted gross incomes of $100,000 or more reported the largest expenditures in terms of dollars and percentage compared to individuals with lower adjusted gross incomes. These taxpayers claimed $916.7 million, or 58.4 percent, of the rehabilitation expenditures reported in 1982 and $1,485.8 million, or 59.6 percent, in 1983.

PARTNERSHIP EXPENDITURES

In this section, we present partnerships' expenditures on historic preservation investments separately from those of individuals and corporation taxpayers to provide a frame of reference for partnerships' investment in historic rehabilitation. IRS requires partnerships to report their income and deductions on Form 1065 and to allocate the partners' shares of income, deductions, credits, etc. on Schedule K or K-1. These amounts are allocated to the partners who, for tax purposes, report it to IRS on their tax returns. (Partners can be individuals, corporations, other partnerships, trusts, fiduciaries, etc.) IRS' Statistics of Income data on rehabilitation expenditures reported by individual and corporation taxpayers also include data from partners' tax returns. Therefore, to avoid double counting, the partnership data presented below should be considered as part of, not an addition to, the individual and corporation taxpayer data previously discussed.

During 1983 and 1982, partnerships reported a total of $2,672.7 million in expenditures for the rehabilitation of certified historic structures and 40- and 30-year buildings. They reported $1,011.1 million in 1982 and $1,661.6 million in 1983. Expenditures for 1983 represent a 64-percent increase over those reported in 1982. The $2,213.7 million in rehabilitation expenditures for certified historic structures account for 83 percent of the total expenditures. Table II.8 shows partnership expenditures by type of rehabilitation and the change in these expenditures between 1982 and 1983.

Table II.8: Partnership Expenditures for Tax Years 1982 and 1983 ($ in millions)

	1982	1983	Total	Amount of change	Percentage change
Certified historic structures	$ 860.0	$1,353.7	$2,213.7	$493.7	57
40-year buildings	134.7	199.8	334.5	65.1	48
30-year buildings	16.4	108.1	124.5	91.7	559
Total	$1,011.1	$1,661.6	$2,672.7	$650.5	64

The expenditure increase of $493.7 million for certified historic structures accounted for the largest increase between 1982 and 1983. In this category of property, partnerships reported a 57-percent increase over 1982 expenditures.

Although rehabilitation expenditures for 30-year old buildings represented the lowest dollar amount among these three categories of property, the largest percentage increase, or 559, occurred in the 30-year old building category. According to IRS, the occurrence of this characteristic on a partnership return is relatively rare and the large variation may be attributable to the sample capturing a specific return with a large weight for 1983.

CERTIFIED HISTORIC STRUCTURE REHABILITATION ACTIVITIES FOR FISCAL YEARS 1977 THROUGH 1985

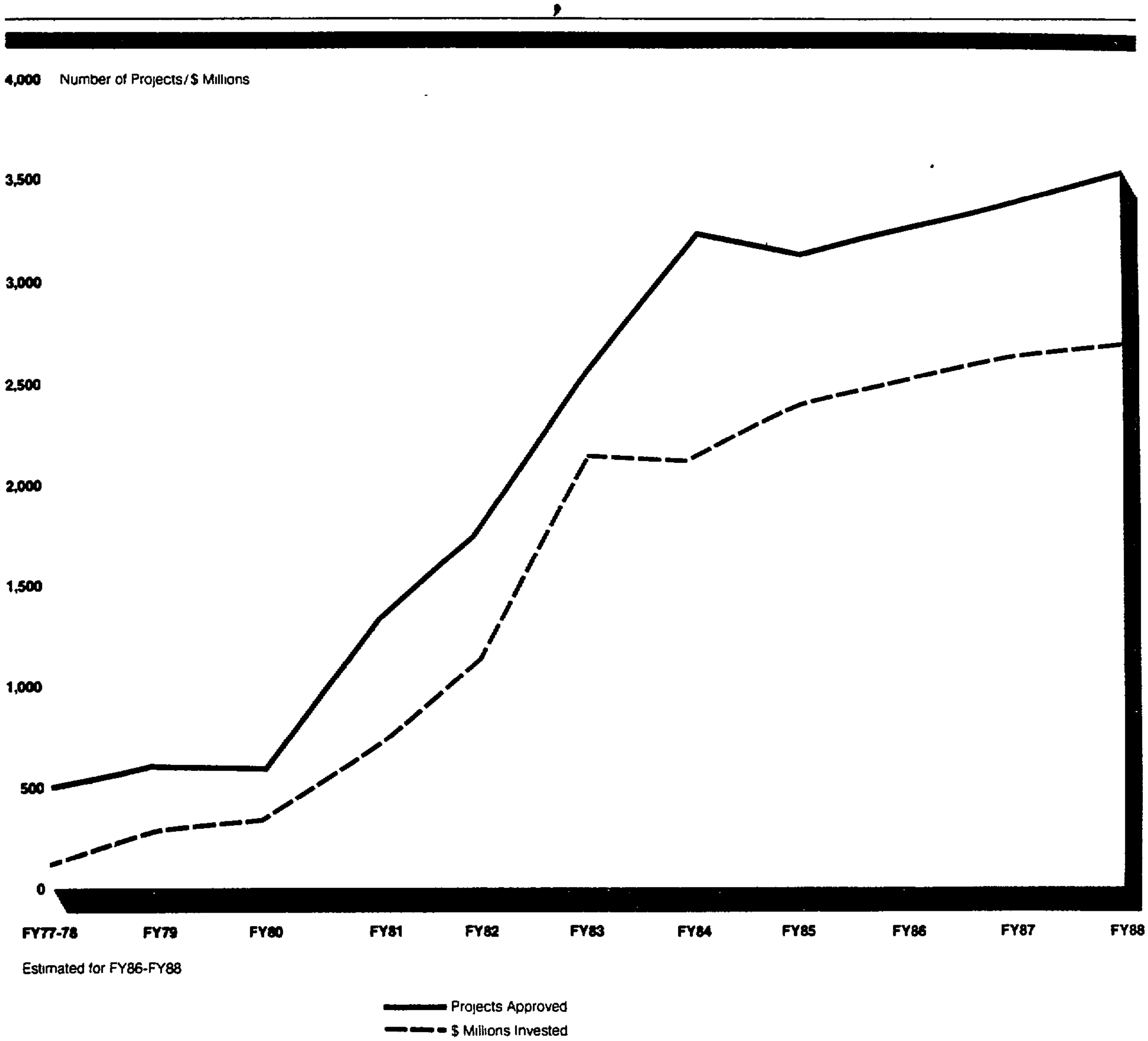
National data on the rehabilitation of certified historic structures during 1977-85 show an increase in NPS' certification activities since 1982. The certification process of the NPS remains basically the same as we reported earlier. NPS relies to a great extent upon the recommendations of the state preservation officers in making its certification decisions. Since ERTA, however, NPS data show dramatic increases in the number of the applications received, approved projects, and estimated expenditures. Consistently from fiscal years 1982 through 1984, over 50 percent of the rehabilitated projects were used for housing.

NPS CASELOAD ACTIVITIES

Although NPS data on the caseload activities of its regional offices show annual increases in certified historic structure rehabilitation activities, a period of more rapid increase in the number of applications received, new projects, and approved projects occurred during fiscal years 1982 through 1984 (see fig. III.1). In fiscal year 1985, the number of new projects and approved projects dropped slightly below their 1984 levels. Based on NPS 1986 and 1987 projections, certified historic structure activities will continue to increase annually but at a slower rate than occurred during fiscal years 1982 through 1984.

Because NPS does not review and approve rehabilitation of 30- and 40-year-old buildings, it does not accumulate similar data on the rehabilitation activities associated with these properties.

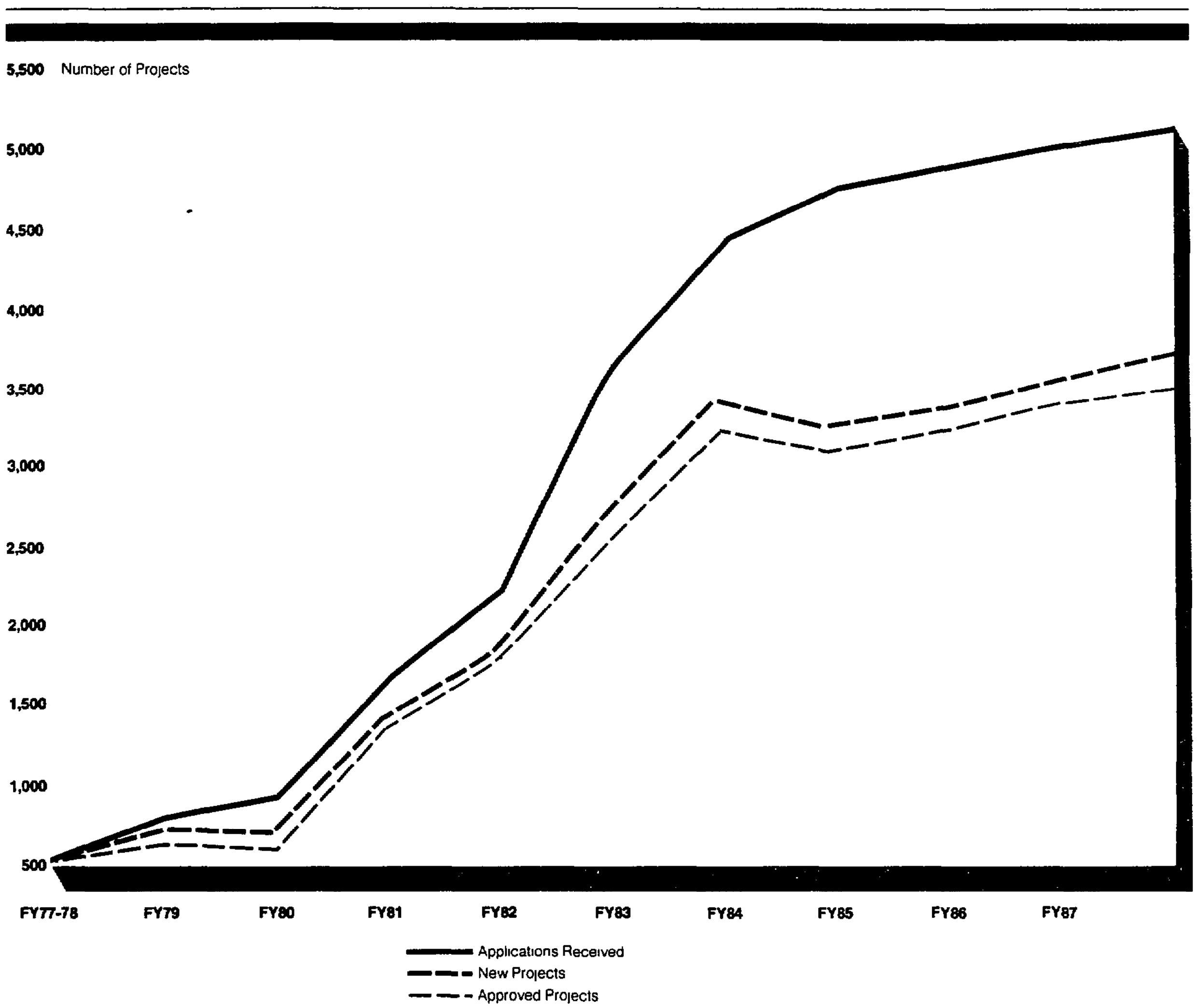
Figure III.1 Preservation Project Activities (Actual Through Fiscal Year 1985; Projected Through Fiscal Year 1987)



Source: Tax Incentives for Rehabilitating Historic Buildings: Fiscal Year 1985 Analysis (Washington, D.C., National Park Service, Technical Preservation Service, March 1986), p. 2.

As shown in figure III.2, NPS relates data on estimated expenditures for the rehabilitation of certified historic structures directly to the number of projects approved. Except for some fluctuation in fiscal years 1982 and 1984, estimated expenditures increased proportionately with the number of approved projects. In fiscal years 1984 and 1985, projects approved increased at a higher rate than the estimated expenditures. Based on fiscal year 1985 actual data and NPS projections for 1986 through 1988, the gap between projects and estimated expenditures appears to stabilize and the rate of increase shows some leveling off.

Figure III.2: Preservation Project and Investment Activities (Actual Through Fiscal Year 1985; Projected Through Fiscal Year 1988)



Source: Tax Incentives for Rehabilitating Historic Buildings: Fiscal Year 1985 Analysis (Washington, D.C., National Park Service, Technical Preservation Service, March 1986), p. 2.

BACKGROUND ON HISTORIC STRUCTURE CERTIFICATION

Responsibility for the certification of state or local districts and statutes, and the historic significance and rehabilitation of structures has been delegated by the Secretary of the Interior to NPS regional offices. State or local historic districts must be certified by NPS as substantially meeting all requirements for listing on the National Register before NPS will process requests for certification of buildings within the districts. Designation as a registered historic district for listing in the National Register may be accomplished by direct NPS certification or by state or local statutes which have been certified by NPS.

A certified historic structure is any structure, subject to depreciation as defined by the Internal Revenue Code, that is (1) listed on the National Register of Historic Places or (2) located in a registered historic district and certified by NPS as contributing to the historic significance of the district.

State preservation officers play an integral role in certifying the significance of structures. Regional NPS preservation officers rely to a great extent upon participating state preservation officers' recommendations to accept or reject applicants' requests for their property to be certified as historically significant. Investors seeking certification submit Part I of NPS' historic preservation application for initial review by a state preservation officer. Following review, which may include an onsite inspection of the property, the state officer makes the initial recommendation on the application and forwards it to one of the five NPS regional offices for a final certification decision.

According to the Secretary's "Standards for Evaluating Historical Significance Within Registered Historic Districts" (36 CFR 67.5), a building has historical significance if its workmanship, location, design, setting, and materials add to the historic district's sense of time and place in historical development. Ordinarily, buildings built within the past 50 years are not considered to contribute to the significance of the district unless a strong justification of their historical or architectural merit is given or the historical attributes of the district are considered to be less than 50 years old. The standards specify that a structure which does not add to the district's sense of time and place and historical development does not contribute to the historic significance of the district. The structure is also not considered appropriate for certification if the integrity of its original design or architectural features or space has been irretrievably lost.

Investors seeking NPS approval of proposed, ongoing, or completed rehabilitation work, submit Part II--description of rehabilitation. Part II is also sent initially to a state preservation officer who determines whether or not the planned rehabilitation meets the Secretary's "Standards for Rehabilitation" (36 CFR 67.7). These standards require that every reasonable effort be taken to restore the property to its original state without alterations which may detract from the original architecture and distinctive design.

Among other things, the standards require that deteriorated features should be repaired rather than replaced. Where replacement is necessary, the new material should match the replaced material in composition, texture, color and in other visual qualities. Contemporary design for alterations and additions are not discouraged if they do not destroy the significant historical, architectural, or cultural material, and are compatible with the size, scale, color, material, and character of the property or environment. After reviewing the proposed, ongoing, or completed projects, the state preservation officer recommends approval or disapproval to the NPS regional office. The NPS regional office makes the final decision on the project and notifies the property owner of its decision.

After rehabilitation is completed, the property owner must also submit a "request for certification of completed work" which notifies the state preservation officer of the completion date, and includes photographs of the completed project and a statement that the rehabilitation was completed in accordance with the Secretary's standards. The state preservation officer reviews this information and may make a site inspection of the project before recommending approval or rejection of the rehabilitation to the NPS regional office. Prior to issuing the final decision, the NPS preservation officer in the region may also conduct an on-site inspection. Rehabilitation expenditures become eligible for tax incentives after NPS' approval of the completed project and its designation of the property as a "certified rehabilitation."

Appeals of NPS regional office decisions are decided by NPS headquarters staff in Washington, D.C.

COMPARISON OF POST- AND PRE-ERTA ACTIVITIES

A comparison of data on post- and pre-ERTA activities associated with the rehabilitation of certified historic structures indicates dramatic increases in these activities since ERTA.

We compared rehabilitation activity data for the post-ERTA period (1982-85) with data for the pre-ERTA period (1977-81) to see if the level of activities associated with the rehabilitation of certified historic structures changed. Based on this comparison, we noted that during the post-ERTA years NPS

--processed about four times as many applications from property owners seeking certifications of historical significance and approvals for planned or completed rehabilitations,

--approved over three times as many planned rehabilitations,

--approved projects with total estimated expenditures five times larger than the total estimated expenditures for planned projects in pre-ERTA years.

Table III.1 shows our comparison of post- and pre-ERTA statistics on activities associated with the rehabilitation of certified historic structures.

Table III.1: Comparison of Post- and Pre-ERTA Certified Historic Structure Rehabilitation Activities

Post-ERTA years	Applications received	Approved projects	Estimated expenditures ($ in millions)	Certified rehabilitations
1985	4,775	3,117	$2,415.8	1,735
1984	4,461	3,214	2,123.1	1,424
1983	3,639	2,572	2,164.9	1,192
1982	2,215	1,802	1,128.4	563
Total	15,090	10,705	$7,832.2	4,914
Average per year	3,773	2,676	$1,958.1	1,229

Pre-ERTA years	Applications received	Approved projects	Estimated expenditures ($ in millions)	Certified rehabilitations
1981	1,654	1,375	$ 738.3	575
1980	931	614	346.2	752[a]
1979	807	635	300.0	
1977-78	549	512	140.0	
Total	3,941	3,136	$1,524.5	1,327
Average per year	788	627	$304.9	265

[a]Represents cumulative approved rehabilitations from fiscal years 1977 through 1980.

For the 1982 through 1985 period, NPS received over 15,000 applications from property owners requesting certification of historical significance and approval of planned or completed rehabilitation projects. Compared with the 3,941 applications for the 1977 through 1981 period, NPS processed about 4 times as many applications as it processed during the 5 years before ERTA. The average number of applications processed per year was 3,773 during the post-ERTA period compared to an annual average of 788 applications for the pre-ERTA period.

Likewise, NPS approved a substantially greater number of proposed plans for the rehabilitation of certified historic structures after ERTA. NPS approved 10,705 planned projects during 1982 through 1985, or over three times more than the 3,136 plans approved during the pre-ERTA years. For comparison, NPS approved an average of 2,676 plans annually since ERTA versus 627 before.

The $7,832 million in investors' estimated expenditures to complete planned rehabilitations of certified structures in the post-ERTA years was over five times the $1,525 million estimated for planned projects during the pre-ERTA years. The annual average estimates were $1,958 million for post-ERTA years and $305 million for the pre-ERTA years.

Since ERTA, NPS approved 4,914 certified historic rehabilitations, or over three and one-half times the 1,327 completed projects approved in prior years. In 1984 alone, NPS approved more certified rehabilitations than it approved during the 5-year period, 1977 through 1981. The average number of projects approved during post-ERTA years was 1,229 as compared to an average 265 projects for the pre-ERTA period.

USE AFTER REHABILITATION

Throughout 1982 to 1985, the uses made of certified historic properties--housing, office, commercial, mixed (residential, office, or commercial combinations)--have, on a percentage basis, remained about the same. Data collected by NPS show that, since 1982, over 50 percent of the rehabilitation projects were used for housing. Mixed use was the second highest category. Table III.2 shows 1982 through 1985 statistics on the uses made of certified historic structures after rehabilitation.

Table III.2: Use of Certified Historic Structures After Rehabilitation for Fiscal Years 1982 Through 1985

Uses	1982	1983	1984	1985	Totals
Housing					
Number of projects	526	1,227	1,546	1,455	4,754
Percent of total	45	54	56	57	54
Mixed (R/O/C)[a]					
Number of projects	231	470	496	479	1,676
Percent of total	20	21	18	19	19
Office					
Number of projects	230	310	391	296	1,227
Percent of total	20	14	14	12	14
Commercial					
Number of projects	97	176	219	242	734
Percent of total	8	8	8	10	8
Other					
Number of projects	83	108	127	66	384
Percent of total	7	5	5	3	4
Total projects	1,167	2,291	2,779	2,538	8,775
Total percent	100	100[b]	100[b]	100[b]	100[b]

[a]Any combination of mixed residential, office, or commercial.

[b]Totals do not add due to rounding.

Source: National Park Service, Preservation Technical Services Division.

IRS COMPLIANCE EFFORTS

IRS is responsible for assuring that taxpayers comply with the tax provisions on (1) the investment tax credits for qualified expenditures used to rehabilitate certified structures, and 40- and 30-year old buildings, and (2) charitable deductions for donated facade easements. Beginning with fiscal year 1983, NPS has been assisting IRS in its compliance efforts by providing IRS with copies of approved and denied historic preservation applications for certified historic structures. Currently, IRS is identifying the magnitude of errors associated with claimed historic preservation tax credits on certified historic structures to determine whether or not it would be cost effective to initiate reviews of the claimed credits.

Regarding donated easements, IRS' Mid-Atlantic Regional Office identified for review 135 cases involving approximately $10 million in charitable deductions claimed by taxpayers. Determining the fair market value of the facades through IRS appraisals has complicated IRS' review and resolution of these cases. In April 1986, the Mid-Atlantic Regional Office began experimenting with the use of flat rate percentages of fair market value to negotiate possible settlement of the cases without IRS appraisals of the facades.

IDENTIFICATION OF ERRORS

In response to our earlier report, IRS initiated a study to identify the extent of compliance errors involving tax credits taxpayers claimed on qualified rehabilitation expenditures. In April 1986, IRS identified a nationwide universe of errors involving qualified expenditures to rehabilitate certified historic structures as reported on taxpayers' 1984 returns. IRS defined an error as occurring when a taxpayer reported either (1) a difference of more than $1,000 between the expenditures shown on IRS Form 3468[1] and the amount shown on the NPS approved application attached, or (2) qualified rehabilitation expenditures on Form 3468 without the required NPS application attached.

Historic expenditure amounts involving apparent errors over $1,000 were stratified into 7 dollar ranges from $1 through $999 to $75,000 and over. Of the 64 returns with potential errors, 29 involved qualified rehabilitation expenditures in the $10,000 to $49,999 range, and 17 were in the $75,000 and over range. The remaining 8 returns contained potential errors in expenditures which were dispersed throughout the other 5 ranges. IRS plans to review the 64 returns.

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[1]IRS Form 3468--Computation of Investment Credit.

Identification and review of the universe of errors are part of the process IRS uses to decide whether or not it would be cost effective to initiate reviews of specific tax provisions. IRS has not yet decided whether to focus on the review of investment tax credits for qualified expenditures to rehabilitate certified historic structures but plans to make this decision by the end of fiscal year 1986.

DONATED EASEMENT REVIEWS

Taxpayers donating certified historic facade easements for conservation purposes may deduct the value of these donations as a charitable contribution on their tax returns. The purpose of the conservation facade easement is to protect the historical and architectural significance of the certified historic structure. The value of the easement is based on the decrease of the structure's fair market value after the donation is made. Taxpayers use appraisals of the structure's fair market value before and after the donation to substantiate the value of their contribution at the time of the donation. The deduction is zero if the donation does not decrease the fair market value of the property.

Section 170(f)(3)(B)(iii) of the Internal Revenue Code allows a deduction for donated facade easements. The property must be a certified historic structure and, as such, facade easements on commercial as well as residential facades may quality for the deduction. Also, further development of the property may be restricted by local, state, or federal standards of the district in which the property is located.

The Mid-Atlantic Regional Office's review of tax returns filed in 1981 through 1983 identified 135 key cases with charitable deductions totaling $10,182,646 for donated facade easements. A key case is defined as a specific facade regardless of the number of tax returns involved. For example, several partners' individual returns may reflect their proportionate shares of a deduction for the donation of one facade by their partnership. Key cases, therefore, as shown in table IV.1, include the dollar amounts from all of the partners' returns associated with a particular facade.

Most of the key cases involve facades located in the Washington, D.C., and Baltimore, Md. metropolitan areas. The 127 cases involving facades in these areas accounted for $6,774,646 of the claimed deductions. Facades in the Philadelphia area accounted for eight of the cases and $3,407,500 of these claimed deductions. IRS staff identified an additional 42 key cases for review but have not determined the amounts of claimed deductions for these cases.

Table IV.1: Key Cases Identified for Review of Donated Historic Facades in the Baltimore, Philadelphia, and Washington, D.C., Areas for Tax Years 1981 Through 1983

Settled key cases	Tax Years 1983	1982	1981	Total
Key cases identified		3	18	21
Dollars claimed		$ 32,475	$1,136,000	$1,168,475
Dollars allowed by IRS		0	398,000	398,000
Difference		32,475	738,000	770,475
Average difference per key case		10,825	41,000	36,698
Key cases pending review				
Key cases identified	40	63	11	114
Dollars claimed	$2,536,671	$4,021,100	$2,455,900	$9,013,671
Average dollars per case	63,417	63,827	223,264	79,067
Totals				
Key cases	40	66	29	135
Dollars claimed	$2,536,671	$4,053,575	$3,591,900	$10,182,146

According to IRS examiners, the assessment of a facade's fair market value by IRS appraisers and engineers represents the most time consuming step of the review process. They explained that no matter how accurate IRS may consider its appraisal, it is still a subjective determination that may be challenged by the taxpayer. Under IRS's prescribed review procedures, appraisers and engineers may spend several weeks addressing the valuation issues of one facade. As a result, the Mid-Atlantic Regional Office developed a backlog of facade easement reviews.

To resolve this backlog, the Mid-Atlantic Regional Office is experimenting with an alternative approach for negotiating the settlement of pending cases involving residential facades. The approach involves developing a flat percentage for a particular geographical area and applying the percentage against the total value of the structure to determine the value of the donated facade easement. IRS agents in the Mid-Atlantic Region then use this value to negotiate a settlement of the disputed claim. If the taxpayer challenges the IRS valuation, IRS Appeals and District Counsel offices will determine the need for an appraisal by IRS.

IRS' CONSERVATION CONTRIBUTION STUDY

In our earlier study, we reported that IRS had undertaken a 5-year study to identify the universe of conservation easements received by tax-exempt organizations over a 5-year period. Statistics of Income Division staff collected data from forms filed by tax-exempt organizations for 3 tax years but identified few valid conservation contributions for analysis.

Responding to congressional concern and the Commissioner's Implementation Plan 96-31 of 1981, the Statistics of Income Division staff collected data on conservation easements from Form 990, Schedule A, filed for tax years 1982 through 1984 by tax-exempt organizations. Schedule A of this form was modified during the data collection period to require descriptive information on any conservation contribution in excess of $5,000. The descriptive information was to include the fair market value of the property as well as the donor's name, social security number, and address. Using this information, IRS could check the donor's tax return and obtain details on the donated easement.

Most of the reported contributions identified by the study were not conservation contributions as defined by section 170(f) of the Internal Revenue Code. According to this section of the Code, conservation contributions include, among other properties, historic land and certified historic property. Cash contributions are excluded from the definition. Of the 83 contributions identified, 52 cases were erroneously reported cash contributions, 5 were for other nonqualifying or inadequately described properties, and 2 involved duplicate returns. Of the 24 valid contributions identified, 2 were historic facade easements.

After collecting the 1984 data, IRS modified Schedule A of Form 990 which no longer requires tax-exempt organizations to report specific information about conservation contributions in excess of $5,000.

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