

TEXAS HISTORICAL COMMISSION
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September 4, 2019

The Honorable Ken Paxton
Attorney General of Texas
Attention: Opinions Committee
P.O. Box 12548
Austin, TX 78711

RQ-0303-KP
FILE # ML-48603-19
I.D. # 48603

Dear General Paxton:

On behalf of the Texas Historical Commission, I ask for your official opinion concerning the implementation and interpretation of Texas Tax Code (TTC), Chapter 171, Subchapter S. This subchapter establishes the Tax Credit for Certified Rehabilitation of Certified Historic Structures, which incentivizes the preservation of historic buildings through the award of a tax credit based on the percentage of construction costs for completed projects. The Texas Tax Credit for Certified Rehabilitation of Certified Historic Structures is modeled on the Federal Historic Preservation Tax Incentives program. Because the Texas law references the federal law this opinion request includes citations to applicable federal statutes.

The Commission has recently received an application for a property owned by an independent school district and operated as part of an active public school. A non-profit entity has been formed to act as the tax credit applicant, indicating on the submitted application that the non-profit holds a long-term lease on the property. The non-profit proposes to undertake a rehabilitation of the building, after which it will be returned to use as a school by the school district. The non-profit will sell the tax credits to an entity subject to the state franchise tax.

Our question is whether or not a nonprofit organization leasing a publicly-owned property can qualify for and obtain the state tax credit on behalf of the public owner who is, presumably, paying the costs of rehabilitation? If so, what restrictions, if any, would apply to this situation?

Applicable statutory and regulatory provisions are as follows.

TTC §171.903 establishes that applicants will qualify for the credit if they have a certified rehabilitation of a historic structure, if they have ownership interest in the structure in the year during which it is placed in service, and if they have eligible costs and expenses of at least \$5000. §171.901(4) provides the definition of eligible costs and expenses, by reference to the federal Internal Revenue Code (IRC), Section 47(c)(2). IRC §47 establishes the Federal Rehabilitation Tax Credit, after which the state tax credit is modeled. §47(c)(2)(a) states, in part:

(A)In general The term “qualified rehabilitation expenditure” [eligible costs and expenses] means any amount properly chargeable to capital account—

- (i) for property for which depreciation is allowable under section 168 and which is—
 - (I) nonresidential real property,
 - (II) residential rental property,
 - (III) real property which has a class life of more than 12.5 years, or
 - (IV) an addition or improvement to property described in subclause (I), (II), or (III), and
- (ii) in connection with the rehabilitation of a qualified rehabilitated building.

The Federal Rehabilitation Tax Credit, therefore, requires that a property have an income-producing use. Further, §47(c)(2)(B)(v) iterates that expenses on portions of buildings that have a tax-exempt use are not qualified rehabilitation expenditures [eligible costs and expenses]. This section additionally references IRC §168(h), which discusses lease structures for tax-exempt use property.

TTC §171.901(4) further states that, for the purposes of the state tax credit, “...the depreciation and tax-exempt use provisions of [§47(c)(2)] do not apply to costs and expenses incurred by an entity exempt from the tax imposed under this chapter by Section 171.063 or by an institution of higher education or university system as defined by Section 61.003, and those costs and expenses are eligible costs and expenses if the other provisions of Section 47(c)(2), Internal Revenue Code, are satisfied.”

Thus, tax-exempt entities may receive the state tax credit with no further obligations, provided that they meet all other rules and requirements for the program. State institutions of higher learning may also receive the credit for work completed, until January 1, 2022, at which time that stipulation of §171.901(4) is removed pursuant to a statutory amendment passed in 2017. Act of April 28, 2017, 85th Leg., R.S., ch. 773, sec. 8 (passed as H.B. 1003). It has been the interpretation of the Commission that no other entities, including other government agencies, meet these qualification requirements and are eligible to pursue the state tax credit. Texas Administrative Code for the THC (Title 13) and the state’s Comptroller of Public Accounts (Title 34) both reflect the requirements and allowances of TTC§171.901(4). The fact that the legislature amended the tax code to provide a temporary qualification of state college and university system buildings supports that interpretation and indicates legislative intent to exclude public properties from application of the credit.

TTC §171.903 refers to “ownership interest” as a necessary element for eligibility for the tax credit. Following the federal tax credit program, the state program allows an entity holding a long-term lease on a property to act as the owner, in order to receive the financial benefit of the program. This requirement is established in IRC §47(c)(2)(B)(iv), referring to Section 168(c). For the purposes of the state tax credit, Texas Administrative Code Title 13 §13.1(18) follows federal law, and specifies that a long-term lessee of a property may be considered an owner if they have leased a property for 27.5 years or 39 years, for residential real property or nonresidential real property, respectively.

IRC §168(h)(B), referenced above, describes "disqualified leases," under which real property leased to a tax-exempt entity is treated as tax-exempt use property. An IRS guidance document, "Property Leased to a Tax-Exempt Entity" explains how a disqualified lease may impact a project's eligibility for the federal tax credit. §168(h)(B)(ii) states:

(ii) Disqualified lease For purposes of this subparagraph, the term "disqualified lease" means any lease of the property to a tax-exempt entity, but only if—

(I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a) and such entity (or a related entity) participated in such financing,

(II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or a related entity) or there is the equivalent of such an option,

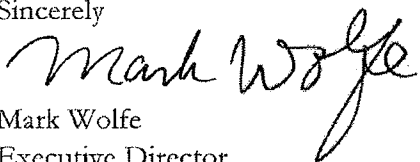
(III) such lease has a lease term in excess of 20 years, or

(IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease.

Our request for an opinion relates to how the disqualified lease provisions of the Internal Revenue Code apply to applicants seeking the Tax Credit for Certified Rehabilitation of Certified Historic Structures under the Texas Tax Code.

Thank you for your consideration of this matter, and please let me know if we can provide any additional information in support of this request. The names and addresses of persons likely to have an interest in this opinion follow at the bottom of this page.

Sincerely



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