

About the Rehabilitation Credit and Low-Income Housing Credit

Internal Revenue Code section 47 provides for the Rehabilitation Credit and Internal Revenue Code section 42 provides for the Low-Income Housing credit. Department of the Treasury regulations contain additional guidance concerning the credits.

The Table was prepared in response to inquiries that have been proposed to the IRS. The information contained in the Table is intended to provide a basic understanding of differences between the Rehabilitation Credit and Low-Income Housing Credit.

The information presented in the Table does not constitute legal authority and may not be relied upon as such. The information does not amend, modify or add to the Income Tax Regulations or any other legal authority.

Rehabilitation Credit	Low-Income Housing Credit
<p>Credit Percentage</p> <p>The rehabilitation credit is the amount equal to 20% of the qualified rehabilitation expenditures with respect to a qualified rehabilitated building. The rehabilitation credit is claimed ratably over a 5-year period starting in the year the building was placed in service.</p>	<p>Credit Percentage</p> <p>The minimum low-income housing credit rate for buildings that are not federally subsidized is 9% of the amount of a building's qualified basis annually for 10 years, and is designed so that the present value of the credit is equal to 70% of the building's qualified basis. A 4% minimum credit rate is available for buildings constructed with federal subsidies or for acquisition costs of buildings that are then substantially rehabilitated, in which case the present value of the credit is designed to be equal to 30% of the building's qualified basis, subject to the applicability of the Taxpayer Certainty and Disaster Tax Relief Act of 2020. The exact percentage for the low-income housing credit generally is based upon the month in which the property is placed in service or, at the taxpayer's election, (1) the month in which allocation is received, or (2) if the aggregate basis of a building and land upon which the building is located is financed 50% or more with tax-exempt bonds, the month in which the tax-exempt bonds are issued.</p>

Rehabilitation Credit	Low Income Housing Credit
<p>Substantial Rehabilitation</p> <p>The rehabilitation credit is only available in connection with the substantial rehabilitation of a building that is a certified historic structure. A certified historic structure must be listed individually in the National Register of Historic Places or located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.</p> <p>A building is treated as having been substantially rehabilitated if the rehabilitation expenditures incurred during the 24-month measuring period selected by the taxpayer exceed the greater of \$5,000 or the adjusted basis of the building at the commencement of the 24-month period. If certain requirements are met, a taxpayer can substitute a 60-month measuring period for the 24-month measuring.</p>	<p>Substantial Rehabilitation</p> <p>The low-income housing credit is available for new construction or substantial rehabilitation. In addition, acquisition costs for an existing building may be eligible for the low-income housing credit in the case of a substantial rehabilitation of the building. For purposes of the low-income housing credit, substantial rehabilitation is defined as expenditures incurred during a 24- month period which are not less than the greater of (1) \$6,000 (adjusted annually for inflation) of qualified basis per low-income unit or (2) 20% of the adjusted basis of the building (determined at the commencement of such 24-month period).</p>
<p>Credit Computation</p> <p>The rehabilitation credit is equal to 20 percent of the qualified rehabilitation expenditures with respect to the qualified rehabilitated building. The rehabilitation credit is claimed ratably over the 5-year period beginning in the year the qualified rehabilitated building is placed in service.</p>	<p>Credit Computation</p> <p>The low-income housing credit is generally determined each year over a 10-year credit period and for any year in the credit period is computed by multiplying the building's applicable percentage and the building's qualified basis.</p> <p>The qualified basis of a building is equal to the applicable fraction of the building's eligible basis. The applicable fraction is the smaller of the unit fraction (percentage of a building's rental units that are qualified low-income units) or the floor space fraction (percentage of total floor space of building's rental units that are qualified low-income units).</p> <p>The eligible basis is generally the building's adjusted basis as of the close of the first taxable year of the credit period.</p>

Rehabilitation Credit	Low Income Housing Credit
<p>Restrictions in Property Type and Expenditures</p> <p>The building must be a certified historic structure.</p> <p>The rehabilitation credit is based upon the amount of qualified rehabilitation expenditures. A qualified rehabilitation expenditure is an amount which is property chargeable to a capital account for property for which depreciation is allowed and which is nonresidential real property, residential rental property, real property which has a class life of more than 12.5 years, or an addition or improvement to such property. Qualified rehabilitation expenditures do not include acquisition costs, or expenditures attributable to the enlargement of an existing building. For example, qualified rehabilitation expenditures do not include expenditures made to buy or improve land, purchase a building, or purchase personal property.</p>	<p>Restrictions in Property Type and Expenditures</p> <p>The eligible basis of a qualified low-income building includes substantially all the depreciable costs of constructing, or rehabilitating a building and property that is used in common areas. In addition, the acquisition costs of a building can be included in eligible basis for purposes of the low-income housing credit provided that certain requirements are met: e.g., the building has not been placed in service within the last 10 years, the building is acquired from an unrelated party and a substantial rehabilitation is undertaken in connection with the acquisition of the building. No low-income housing credit is permitted for non-depreciable land costs.</p>
<p>Tax-exempt Use Property Rules</p> <p>The rehabilitation credit is generally not available for property used by tax-exempt entities, which includes governments, foreign persons, or foreign entities.</p> <p>Taxpayers can lease their property to a tax-exempt entity provided the lease does not result in a disqualified lease. An exception under the Treasury Regulations provides that property is not considered tax exempt use property if 50% or less of the property is leased to tax-exempt entities in disqualified leases. Disqualified leases generally include leases in excess of 20 years, leases with purchase options and sale-lease back arrangements.</p>	<p>Tax-exempt Use Property Rules</p> <p>The low-income housing credit is not subject to the tax-exempt use property rules. However, residential rental units must be leased to qualified low-income tenants and the rents must be restricted.</p>
<p>Use Commitment</p> <p>The rehabilitation credit provisions do not include an extended use provision. However, the rehabilitation credit may be recaptured during the 5-year credit recapture period if the property is disposed of or ceased to be investment credit property.</p>	<p>Use Commitment</p> <p>The low-income housing credit requires an owner to have an extended low-income housing commitment in place with the housing credit agency. That commitment requires the building be maintained as low-income housing for a period of not less than 30 years. The owner is also subject to recapture of the low-income housing credit during a 15-year compliance period.</p>

Rehabilitation Credit	Low Income Housing Credit
<p>Pass-through Election</p> <p>The owner of rehabilitation credit property can elect, under certain circumstances, to treat lessee of the property as having purchased the property solely for purposes of the rehabilitation credit. If such election is made, the lessee is allowed to take the qualified rehabilitation expenditures into account for claiming the credit provided certain requirements are met.</p>	<p>Pass-through Election</p> <p>The owner of low-income housing credit property cannot elect to pass through the credit to the tenants.</p>
<p>Property Location</p> <p>The rehabilitation tax credit is equal to 20% of the qualified rehabilitation expenditures without regard to where the building is located. A rehabilitation credit, however, is not allowed with respect to property used outside the United States.</p>	<p>Property Location</p> <p>For purposes of low-income housing credit, possession of the United States are included in as a “State”. Further, if a qualified low-income housing building is located in either a qualified census tract (e.g., a designated tract in which 50% or more of the households have an income that is less than 60% of the area median gross income) or in a difficult development area (a designated area which has high construction, land, or utility costs relative to area median gross income), the eligible basis for purposes of the credit may be increased by up to 130% of the amount of such expenditures.</p>
<p>Adjustments When Combining Credits</p> <p>The rehabilitation credit is not affected by the low-income housing credit. The basis of the property must be reduced by the amount of the rehabilitation credit determined.</p>	<p>Adjustments When Combining Credits</p> <p>The eligible basis for purposes of computing the low-income housing credit must be reduced by the amount of the rehabilitation credit determined.</p>
<p>Federal Grants</p> <p>A taxpayer must determine whether amounts related to grant proceeds are qualified rehabilitation expenditures for purposes of calculating a rehabilitation credit. In the case of grant proceeds received by the taxpayer, the taxpayer must determine, under all the facts and circumstances, if any or all of the grant proceeds result in an addition to the basis of the property. As part of this determination, whether the grant proceeds are includible in gross income may be relevant. Any amount that is not added to the basis of such property does not qualify as a qualified rehabilitation expenditure.</p>	<p>Federal Grants</p> <p>The eligible basis of a low-income housing credit property must be reduced by the amount of any federal grant which is used for the building (or for its operation), regardless of whether the amount of such grant has been taken into income or when the grant is received during the 15-year compliance period.</p>

Rehabilitation Credit	Low-Income Housing Credit
<p>Federal Subsidies</p> <p>The rehabilitation credit provisions do not provide restrictions on the receipt of a federal subsidy in the form of a below-market interest rate loan or the use of tax- exempt bonds.</p>	<p>Federal Subsidies</p> <p>The receipt of a federal subsidy in the form of tax- exempt bonds requires use of the 4% (instead of the 9%) low-income housing credit unless the taxpayer elects to reduce the eligible basis of the building by the amount of federally subsidized financing.</p>
<p>When Credit is Claimed</p> <p>The rehabilitation credit is generally claimed ratably over the five-year period beginning in the year the building is placed in service.</p> <p>In the case of self-rehabilitated property, the rehabilitation credit may be claimed earlier if the taxpayer is eligible for and elects treatment under the qualified progress expenditure rules.</p>	<p>When Credit is Claimed</p> <p>The low-income housing credit generally may be claimed over a 10-year credit period starting with the year the building meets the elected minimum set-aside requirement for occupancy by qualified tenants, but not later than the end of the year following the year that the building is placed in service. There are special rules for multi-building or phased projects. The credit is not available for a dwelling unit until such dwelling unit is occupied by a qualified tenant.</p>
<p>Placed in Service</p> <p>In general, property is “placed in service” when the property is placed in a condition or state of readiness and availability for a specifically assigned function. A building generally is "placed in service" when the appropriate work has been completed which would allow for occupancy of either the entire building, or some identifiable portion of the building.</p>	<p>Placed in Service</p> <p>A new low-income housing building is generally considered placed in service when it is ready and available for its specifically assigned function, e.g., when the first unit in the building is certified as being suitable for occupancy in accordance with state law. Rehabilitation expenditures are treated as placed in service at the end of the 24-month period for aggregating these expenditures, or may be treated as placed in service upon completion of the rehabilitation if the completion is before the end of the 24-month period, provided that on such date the taxpayer has met the test set forth above for qualifying the building as a substantially rehabilitated building.</p>

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<p>Basis Adjustment</p> <p>The taxpayer that directly owns the property must reduce the basis of the property by the amount of the rehabilitation credit. If a partnership owns the building, the adjusted basis of a partner's interest in the partnership must be appropriately adjusted to take into account the adjustment to the basis of the rehabilitation credit.</p> <p>Different rules apply in leasing arrangements where the lessor of the property elects to treat the lessee as having acquired the property. Instead of a basis adjustment, a lessee must include in gross income, over a certain period of time, an amount equal to the amount of the rehabilitation credit determined.</p>	<p>Basis Adjustment</p> <p>No adjustment to depreciable basis or the capital accounts is required in the case of the low income housing credit.</p>
<p>At Risk Rules</p> <p>Individuals and certain corporations that claim the rehabilitation credit are subject to at-risk rules. At-risk rules limit any losses incurred by the taxpayer in connection with certain trades or businesses to the amount with respect to which the taxpayer is at risk. Also, the amount of non-recourse financing with respect to qualified rehabilitation expenditures (even if the financing otherwise constitutes qualified commercial financing) cannot exceed 80% of the credit base of the qualified rehabilitation expenditures.</p>	<p>At Risk Rules</p> <p>The low-income housing credit is subject to the at-risk rules, but unlike the rehabilitation credit there is no percentage requirement tied to non-recourse financing.</p>

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<p>Passive Activity Loss Rules</p> <p>Passive Activity Loss (PAL) rules apply to Individuals, Estates, Trusts, Personal Service Corporations and Closely Held C Corporations. If the building is used in a passive activity the credit will generally be limited to the tax on net passive income.</p> <p>An exception to this general rule exists for certain taxpayers who actively participate in real property rentals and have incomes below \$250,000. This exception allows a credit equivalent to the deduction of up to a \$25,000 of loss. The \$25,000 amount is reduced to \$0 at the rate of 50 cents per dollar that income exceeds \$200,000; it is also reduced by any loss allowed.</p> <p>The building is used in a passive activity if it is: (1) rented to others (with an exception for a Real Estate Professional who materially participates in the rental activity) or (2) used in a trade or business in which the taxpayer does not materially participate. See Publication 925, Passive Activity and At-Risk Rules, for a further discussion of PAL rules and credit limitations.</p>	<p>Passive Activity Loss Rules</p> <p>The PAL rules that apply to the Rehabilitation Credit apply to the low-income housing credit . However, the exception to the general rule allowing a credit equal to the equivalent of up to a \$25,000 loss is applied without reference to income.</p> <p>Since the properties on which the low-income housing credit applies are rentals, the property is a passive activity unless the taxpayer is a Real Estate Professional who materially participates in the rental property. See Publication 925, Passive Activity and At-Risk Rules, for more information on the PAL rules and credit limitations.</p>
<p>Ownership Requirement</p> <p>Taxpayers that own an interest in the building directly or through a passthrough entity, or are lessees of the building in certain cases, are eligible to claim the rehabilitation credit.</p> <p>Lessees of buildings may qualify for the rehabilitation credit if the lessee has a long-term lease or the lessor that owns a building elects to treat a lessee of the building (or a portion of the building) as having purchased the building solely for purposes of the rehabilitation credit. The lessee of the building (or a portion of the building) is allowed to take the qualified rehabilitation expenditures into account for claiming the rehabilitation credit provided certain requirements are met.</p>	<p>Ownership Requirement</p> <p>The low-income housing credit is available to the building owner(s) beginning in the year that the building meets the minimum set aside requirements, but not later than the year after the year the building is placed in service. The low-income housing credit rules permit the disposition of a building and continuation of the credits once the credit has been allocated. However, the former owners is subject to recapture if the property is not maintained as low-income housing throughout the 15-year compliance period.</p>

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<p>Partnership Allocation Rules</p> <p>Qualified rehabilitation expenditures must be allocated in accordance with the partner's interest in a partnership. In general, qualified rehabilitation expenditures are allocated among partners of a partnership based on their shares of general profits.</p>	<p>Partnership Allocation Rules</p> <p>The low-income housing credit is generally allocated among partners in a partnership based on the allocations identified in the partnership agreement. If a partnership expense that gives rise to the low-income housing credit in a partnership also gives rise to valid allocations of partnership loss or deduction, such as depreciation deductions, then the partners' interests in the partnership with respect to such credit are in the same proportion as the partners' distributive shares of the loss of deduction.</p>
<p>Profit Motive</p> <p>The rehabilitation credit provisions do not specifically address profit motive. However, the IRS has successfully challenged the investor's status as a partner and thus, their right to claim the credit for transactions in which a tax credit investor has no meaningful risk of loss or profit potential.</p>	<p>Profit Motive</p> <p>The rule that disallows losses, deductions, or credits when there is a lack of a profit motive does not apply in the case of a qualified low-income building that is allowed to claim the low-income housing credit. However, other rules, such as the at-risk rules, may result in limitations, as well as application of other principles of tax law, for example, the transaction must not be a "sham" and the person or entity claiming the low-income housing credit must have a bona fide ownership interest in the property.</p>
<p>Tax Credit Recapture</p> <p>The rehabilitation credit is subject to recapture if the property is disposed of or otherwise ceases to be investment credit property during the 5-year recapture period.</p> <p>The recapture percentage is 100 percent for property that ceases to be investment credit property within one full year after it is placed in service, reduced by 20 percentage points for each year held during the 5-year recapture period.</p>	<p>Tax Credit Recapture</p> <p>The low income housing credit is subject to recapture over the 15-year compliance period in the event of non-compliance with the low-income housing credit rules or disposition of the low-income building.</p> <p>The recapture amount is the accelerated portion of the credit plus interest at the overpayment rate. The accelerated portion of the credit is the excess of the amount of credit claimed over the amount that would have been allowable for the relevant years if the aggregate credit had been allowable ratably over a 15-year period.</p>

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<p>Governmental Approval/Allocation</p> <p>The rehabilitation credit is not allocated by any governmental agency or approval process. However, buildings must be determined by the Secretary of the Interior, through the National Park Service, to be “certified historic structures.”</p>	<p>Governmental Approval/Allocation</p> <p>In general, the low-income housing credit is available through a competitive allocation process conducted by state housing credit agencies. Projects are ranked based on the state's identified housing priorities and criteria appropriate to local conditions. The annual credit available to each state generally is based on the state's population multiplied by a specific amount, that is annually adjusted for inflation, or a minimum dollar amount for less populated States. These tax credits are also separately available to projects financed by tax-exempt bonds issued under the private activity bond volume cap of Internal Revenue Code Section 146.</p>