

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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The Honorable Jim McDermott
Member, U.S. House of Representatives
1809 7th Avenue, Suite 409
Seattle, WA 98101

Attention:

Dear Representative McDermott:

I am responding to your inquiry dated August 16, 2016, on behalf of your constituent, _____, who is the _____, a tax-exempt section 501(c)(3) organization. _____ wrote that _____ proposed rehabilitation project will not qualify for the historic tax credit due to the prohibitions on tax-exempt use under section 168(h) of the Internal Revenue Code (Code). He asked whether this provision of the law can be changed or whether _____ can get an exception.

Overall, it appears that Congress would need to change the law for the rehabilitation of _____ to qualify for the rehabilitation credit. Nonetheless, I hope the following information about the historic tax credit, also known as the rehabilitation tax credit, is helpful in explaining why _____ does not qualify for the credit.

The rehabilitation credit for any taxable year is 20 percent of the qualified rehabilitation expenditures for any certified historic structure (section 47(a)(2) of the Code). The term "qualified rehabilitation expenditure" does not include any expenditures to rehabilitate any portion of the building that is, or is reasonably expected to be, tax-exempt use property.

Tax-exempt use property for nonresidential real property means the portion of the property leased to a tax-exempt entity in a disqualified lease (section 168(h)(1)(B)(i) of the Code). A disqualified lease includes any lease to a tax-exempt entity if:

- The lease occurs after a sale (or other transfer) of the property by, or lease of the property from, that entity (or a related entity); and
- That entity (or a related entity) used the property before its sale (or other transfer) or lease (section 168(h)(1)(B)(ii)(IV) of the Code).

Section 168(h) of the Code provides several exceptions to the prohibitions on tax-exempt use, but _____ does not indicate that any of those exceptions apply to _____ situation. Thus, the proposed rehabilitation of _____ will not qualify for the rehabilitation tax credit. This is due to the prohibitions on tax-exempt use under section 168(h) that bar _____ from leasing the property from a lessor after its rehabilitation because it is currently using the property.

The IRS does not have authority to grant exceptions to the prohibitions on tax-exempt use that are not authorized by statute.

Therefore, as noted above, Congress would need to change the law for the rehabilitation of _____ to qualify for the rehabilitation credit.

Please call _____ at _____ or me at _____ if you have questions.

Sincerely,

Scott K. Dinwiddie
Associate Chief Counsel
(Income Tax and Accounting)