Alexander v. Commissioner, 92 T. C. 39 (1989)

The rehabilitation tax credit applies to the entire historic building, not to portions of the building, requiring rehabilitation expenditures to exceed the adjusted basis of the whole building.

Summary

Karl R. Alexander III and Mary T. Dupre purchased a certified historic structure in Philadelphia and renovated it into a rental unit and personal residence. They claimed a rehabilitation tax credit based on the expenditures for the rental portion alone, arguing that this portion should be treated as a separate building. The Tax Court rejected their claim, holding that the credit applies only if the rehabilitation expenditures exceed the adjusted basis of the entire building. The decision was based on the plain language of the statute, its legislative history, and related regulations, emphasizing that Congress intended the credit to incentivize the rehabilitation of entire historic structures, not just portions.

Facts

In 1984, Alexander and Dupre bought a property in Philadelphia, which they identified as a certified historic structure. They renovated the first floor into a rental unit and the upper three floors into their personal residence. The total cost of the rehabilitation was $51,610, with $39,465 spent on the rental portion. They claimed a $9,866 rehabilitation tax credit, arguing that the expenditures on the rental unit exceeded its allocated adjusted basis of $21,607.

Procedural History

The IRS determined deficiencies in the taxpayers' income tax for 1982, 1983, and 1985, disallowing the claimed rehabilitation tax credit. The taxpayers petitioned the Tax Court, which heard the case on stipulated facts and exhibits. The Tax Court sustained the IRS's determination, denying the tax credit.

Issue(s)

1. Whether the rehabilitation tax credit can be applied to a portion of a certified historic building if the rehabilitation expenditures for that portion exceed its allocated adjusted basis?

Holding

1. No, because the Internal Revenue Code and its legislative history clearly indicate that the credit applies to the entire building, requiring the rehabilitation expenditures to exceed the adjusted basis of the whole building.

Court's Reasoning

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The Tax Court's decision was based on the following reasoning: The Internal Revenue Code, specifically section 48(g), defines a "qualified rehabilitated building" as the entire building, not portions thereof. The court found that the language of the statute did not support the taxpayers' contention that a portion of a building could be considered "substantially rehabilitated" independently. The legislative history of the 1981 amendments to section 48(g) further supported this interpretation, as Congress had removed provisions allowing credits for rehabilitating major portions of buildings. Additionally, Treasury regulations and Department of Interior guidelines reinforced that the entire building must be considered for the credit. The court rejected the taxpayers' arguments based on cases involving mixed-use properties, as those situations did not involve the specific statutory and regulatory framework governing historic rehabilitation credits.

Practical Implications

This decision clarifies that for historic rehabilitation tax credits, the entire building must be considered, not just portions used for different purposes. Taxpayers planning to rehabilitate historic structures must ensure that their total rehabilitation expenditures exceed the adjusted basis of the entire building to qualify for the credit. This ruling may affect how developers and property owners approach the rehabilitation of historic properties, potentially impacting the financial feasibility of projects that focus on rehabilitating only a part of a building. Legal practitioners advising on historic preservation must consider this ruling when structuring rehabilitation projects to maximize available tax incentives. Subsequent cases, such as Historic Boardwalk Hall, LLC v. Commissioner, have followed this principle, further solidifying the requirement to consider the entire building for rehabilitation tax credit purposes.

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