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A Public Policy Report produced by the National Trust Center for State and Local Policy and published by National Trust Forum, a program of the Center for Preservation Leadership

State Tax Credits for Historic Preservation

by Harry K. Schwartz

By 2007 more than half the states in the country had adopted laws creating credits against state taxes to provide incentives for the appropriate rehabilitation of historic buildings. In most cases these tax credits take the form of the very successful federal income tax credit for historic rehabilitation contained in Section 47 of the Internal Revenue Code.

Although the tax credits vary from state to state, most programs include the following basic elements:

- Criteria establishing what buildings qualify for the credit.
- Standards to ensure that the rehabilitation preserves the historic and architectural character of the building.
- A method for calculating the value of the credit awarded, reflected as a percentage of the amount expended on that portion of the rehabilitation work that is approved as a certified rehabilitation.
- A minimum amount, or threshold, required to be invested in the rehabilitation.
- A mechanism for administering the program, generally involving the state historic preservation office and, in some cases, the state department of revenue.

Why Some State Credits Work Better Than Others

Not all state tax credit programs are created equal. Some state programs have been extraordinarily productive in stimulating rehabilitation activity. Many others have produced mixed or minimal results. What causes these programs to fall short? In general, two factors greatly influence the effectiveness of the state historic tax credits: a limit or cap on the amount of credit and a lack of transferability.

Annual Aggregate Caps

A well-thought-out and skillfully drafted tax incentive for historic preservation cannot achieve its objectives if the amount of credits that can be awarded annually is subject to a statutory limit, particularly if the limit is fixed at a low figure. For example, Kentucky has a 20 percent credit for commercial buildings and a 30% credit for owner-occupied residences only, but only a \$3 million annual cap. Indiana has annual aggregate caps of just \$450,000 for commercial projects and \$250,000 for residential projects.

Even if the annual limit is relatively high, the very act of imposing a cap alters the nature of the program and can produce a perverse result, rewarding projects that do not require an incentive while excluding projects that cannot proceed without the state incentive.

Under Maryland law, the cap is set by annual appropriation. Applicants must compete for available funds, and individual jurisdictions are subject to sub-limits. Consequently, despite the relatively high overall cap, sponsors of smaller and more marginal projects, particularly in Baltimore City, have tended to be discouraged from



Scientific Properties, LLC, used state and federal historic rehab tax credits to rehabilitate a former auto garage into state-of-the-art lab space for emerging biotech businesses in Durham, N.C. The Triangle Biotechnology Center also offers hands-on educational opportunities for area disadvantaged youth. Photo by Andrew Rothschild.

participating in the program because of the lack of certainty of outcome, the cost of preparing a competitive application that may nevertheless be unsuccessful, and the difficulties of keeping financing commitments in place during the evaluation process, among others.

Individual Project Capping

Although limits on the amount of credits that can be awarded to an individual project are common and acceptable when the credit is sought for the rehabilitation of an owner-occupied single family residence, when low limits are fixed on commercial projects, they effectively defeat the desired incentive.

Colorado law, for example, limits the amount of tax credits that may be awarded to a single project to \$50,000. While this does not impair the credit's usefulness for homeownership rehabilitation, it is far too low a figure to affect decisions regarding substantial commercial projects.

Transferability

A state tax credit has value only to the extent that the credit holder has sufficient liability for state taxes that the credit can be used to offset. Although state tax rates vary, they are far lower than federal income tax rates. As a consequence, an apparently valuable state tax credit may wind up in the hands of a party unable to use it. There are several remedies to solve this problem, but many state statutes do not provide for them.

Continued



Patriot Place Apartments, LLC, used state and federal historic rehab tax credits and funding from the National Trust Loan Funds to rehabilitate a fire-ravaged apartment building in the Harry S. Truman National Historic Landmark district in Independence, Mo. The project produced 17 apartment units, including 10 reserved for low- to moderate-income renters. Photo by Lisa Weissman.

What Makes a State Tax Credit “Good?”

A successful state tax credit program will contain the following components:

Eligible Buildings

The scope of eligible buildings should include:

1. buildings individually listed in the National Register of Historic Places,
2. buildings located in historic districts listed in the National Register that contribute to the historic character of the district,
3. individual buildings that have been locally designated as landmarks, and
4. buildings located in local historic districts that contribute to the historic character of the district.

Standards for Rehabilitation

The state should adopt the Secretary of the Interior’s Standards for Rehabilitation, as interpreted by the state historic preservation officer.

Availability for Homeowners

The credit should be available for owner-occupied residences as well as commercial property. This is particularly important because there is no federal credit for owner-occupied residences.

Appropriate Rates

The percentage rate of the credit should be fixed at a level high enough to constitute a meaningful incentive, typically in the range of 20 percent to 30 percent of qualified rehabilitation expenditures. Rates that are significantly lower don’t provide enough incentive to make a difference in a developer’s decision to undertake a historic preservation project.

As a negative example, Michigan provides a 25 percent tax credit for the rehabilitation of commercial structures, but reduces its credit to 5 percent when the federal 20 percent credit is used. Since the federal

credit is almost universally used in commercial projects, the effective rate in Michigan is 5 percent.

Transferability

As mentioned earlier, there needs to be a workable mechanism to put the credit in the hands of the party that can use it. States have solved this problem in one or more ways:

1. The tax code may permit the party that earns the credit to sell it outright to a third party with adequate tax liability to use it. For example, Rhode Island and Missouri permit the taxpayer to sell or convey the tax credits in this manner.

2. The code may permit a partnership that owns the property to make a disproportionate distribution of the credit, so that a local taxpayer can acquire the state tax credit while a national corporation not doing business in the state acquires the federal tax credit. Virginia, Kansas, and Delaware, for example, allow the credit to be passed through and allocated to partners or shareholders in this way.

3. The code may allow a tax credit not fully usable in the current year to be carried back to offset taxes previously paid for prior tax years. This provision appears to be unique among the states to Missouri and West Virginia, although it is a feature of the federal program.

4. The tax credit may be refundable, so that any amount not used to offset current-year taxes is paid in cash to the holder of the credit. Since homeowners earning credits are effectively precluded from using the more complex techniques for transferring credits, the most practical solutions for them are to allow the unused credit to be either refunded or sold outright. Maryland, Ohio, Iowa, and Louisiana provide a fully refundable tax credit, which is of particular value to lower-income homeowners.

Annual Aggregate Caps

Although state legislatures and their fiscal analysts prefer to keep a tight grip on the award of tax credits, those states that have resisted capping have had an economic advantage in attracting capital for historic preservation.

For more information about state tax credits for historic preservation and a list of useful state contacts, visit www.nationaltrust.org/advocacy/.

Harry K. Schwartz is a consultant to the National Trust on state tax incentives.



Property owners in Virginia can take advantage of a 25 percent state tax credit for rehabbing a National or state register property. Pictured above is 2114 East Main Street in the Shockoe Valley and Tobacco Row Historic District located in Richmond, Va. Photo courtesy of the Virginia Department of Historic Resources.

| State | State Income Tax Credit | Contact |
|-------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Colorado | 20% credit for income-producing and homeowner properties. No aggregate statewide dollar cap, but per project cap of \$50,000 per year. Minimum investment: \$5,000. Carry forward: 10 years. DOI standards apply and work must be completed within 2 years of inception date of project. CLG can review and approve project. Sunset date for credit is 2009. | Colorado Historical Society 303-866-3395 http://www.coloradohistory-oahp.org/programareas/itc/taxcredits.htm |
| Connecticut | Commencing Jan. 1, 2008, 25% credit for mixed residential (includes owner-occupied and rental) and nonresidential uses where at least 33% of total square footage of rehab is for residential use. 5% add-on credit for affordable housing. Cap: \$50 million over 3 years and \$5 million per project. Carry forward: 5 years. Freely transferable either by direct sale or disproportionate allocation among partners of a syndication partnership. 25% credit for rehabilitating commercial or industrial buildings for “residential use.” Cap: \$2.7 million per project and \$15 million annual aggregate. Carry forward: 5 years. Freely transferable either by direct sale or disproportionate allocation among partners of a syndication partnership. Minimum expenditure: 25% of assessed building value. 30% credit for eligible rehab of owner-occupied residence, including apartments up to 4 units. Eligible properties: National and/or State Register of Historic Places, must be located in areas targeted as distressed. Cap: \$30,000/dwelling, \$3 million statewide/year. Recapture period 5 years. Carry forward: 4 years. Minimum expenditure: \$25,000. | Connecticut Historical Commission 860-566-3005 http://www.cultureandtourism.org |
| Delaware | 20% credit for income-producing properties and a 30% homeowner credit. A 10% bonus credit applies for both rental and owner-occupied projects that qualify as low-income housing. Carry forward: 10 years. Homeowner credit cannot exceed \$20,000. Credits are freely transferable either by direct transfer or disproportionate allocation. The credit to be claimed in annual progress-based installments with phased projects. Changes in 2005 increased the maximum amount of credits in any fiscal year to \$5 million. | Delaware State Historic Preservation Office 302-739-5685 www.history.delaware.gov/preservation/taxcredit.shtml |
| Georgia | 20% credit for eligible income-producing properties; 10% for owner-occupied properties in non-target area and 15% for owner-occupied properties in target area. Project limit of \$5,000 in credits over 10 years. Transfer permitted by disproportionate allocation. | Georgia Historic Preservation Division 404-656-2840 www.dnr.state.ga.us/dnr/histpres |
| Indiana | 20% of rehab costs up to \$100,000 for qualifying commercial, rental housing, barns and farm buildings. Minimum investment \$10,000. Per-project cap: \$100,000. \$450,000 annual statewide cap for commercial credits and \$250,000 for owner-occupied residences. State register properties qualify. Carry forward: 15 years. Pre-approval of work required. No fees. DOI standards apply. Owner-occupied residential: 20% of rehab costs. Costs must exceed \$10,000. | Indiana Department of Natural Resources 317-232-1646 http://www.state.in.us/dnr/historic/incentives.html |
| Iowa | 25% credit for eligible commercial, income-producing and non-income-producing residential properties and barns built before 1937. Annual cap: \$10 million State Fiscal Year 2008, \$15 million SFY2009, and \$20 million SFY2010 and each fiscal year thereafter. Cap: \$100,000 per residential unit. Fully refundable with interest or may be credited for the following year. Minimum expenditure: 50% of the assessed value of the commercial property, excluding the land; \$25,000 or 25% of the fair market value of the residential or barn property, excluding the land. Set asides: 10% of credits for small projects; 40% for projects located in Cultural and Entertainment Districts. | State Historical Society of Iowa Historic Preservation and Cultural and Entertainment District Tax Credit Program 515-281-4137 http://www.iowahistory.org/preservation/financial_assistance/state_tax_credit/ia_state_tax_credit.html |
| Kansas | 25% income tax credit for commercial and residential properties. Carry forward: 10 years. \$5,000 minimum on qualified expenditures necessary. Credit freely transferable either by direct transfer or disproportionate allocation. No annual program cap, and no per-project cap. | Kansas State Historical Society 785-272-8681 http://www.kshs.org/resource/statetax.htm |
| Kentucky | 30% income tax credit for owner-occupied residential properties. A minimum investment of \$20,000 is required, with the total credit not to exceed \$60,000. 20% income tax credit for all other properties including properties owned by entities exempt from tax under Section 501(c)(3) of the Internal Revenue Code and state and local governments. Minimum investment of \$20,000 or the adjusted basis, whichever is greater, subject to \$400,000 per project cap. Credit is freely transferable. \$3 million total program cap annually. | Kentucky Heritage Council 502-564-7005 http://www.heritage.ky.gov |

| State | State Income Tax Credit | Contact |
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| Louisiana | 25% credit for income-producing properties in “downtown development districts.” \$5 million cap per taxpayer for structures within a downtown development district. No state-wide cap for commercial credits. Directly transferable. 5 year carry-forward for commercial credits. 25% rate for owner-occupied residences, adjusted down based on income. \$1 million statewide cap for owner-occupied residences. Homeowner credit must be taken in five equal annual installments and is fully refundable. Minimum investment: \$10,000 for income-producing properties; \$20,000 for owner-occupied residences. | Louisiana Department of Culture, Recreation & Tourism 225-342-8160 http://www.crt.state.la.us/hp/taxincentives.htm |
| Maine | 20% credit for rehab of income-producing properties eligible for the federal tax credit. Minimum expenditures: same as federal tax credit. Cap: \$100,000/year, per taxpayer; no annual statewide cap. | Maine Historic Preservation Commission 207-287-2132 http://www.maine.gov/mhpc |
| Maryland | 20% credit for commercial and tax exempt entities under IRC 501(c)(3) and owner-occupied residences. Through FY2010, annual appropriation required for commercial credit; no annual cap for owner-occupied residences. Per-project cap: commercial – \$3 million; Owner-occupied – \$50,000. Competitive award process for commercial credits. No competition for credits for owner-occupied structures. No more than 75% of funds available in any year may go to any single jurisdiction. Minimum investment: \$5,000 for homeowners and a rehab cost that exceeds the adjusted basis of the property for commercial applicants. Fully refundable. | Maryland Historical Trust 410-514-7628 http://www.marylandhistoricaltrust.net/taxcr.html |
| Massachusetts | 20% credit for eligible income-producing properties. 25% credit for projects with affordable housing. \$50 million annual statewide cap. Carry forward: 5 years. DOI standards apply. Permits direct transfer of credit or transfer by disproportionate allocation. Minimum investment: 25% of adjusted basis. | Massachusetts Historical Commission 617-727-8470 http://www.sec.state.ma.us/mhc/mhctax/taxidx.htm |
| Michigan | 25% credit for qualified rehab of historic commercial and owner-occupied residential buildings. Commercial credit reduces to 5% when federal 20% credit is claimed. Eligibility: National, state, or local designated properties. DOI standards apply. Minimum expenditures: 10% of State Equalized Value of the property. 5 year recapture period. Carry forward: 10 years. Commercial credit permits transfer by disproportionate allocation. | Michigan Historical Center 517-373-1630 http://www.michigan.gov/hpcredit |
| Mississippi | 25% credit for commercial property and for owner-occupied residences. Upcapped credit with minimum investment of 50% of the total basis for commercial properties; \$5,000 for owner-occupied residences. Carry forward: 10 years. | Division of Historic Preservation, Mississippi Department of Archives and History 601-576-6940 http://www.mdah.state.ms.us/hpres/prestaxinent.html |
| Missouri | 25% credit for commercial and owner-occupied residential properties listed in National Register or in a certified historic district. Minimum investment: 50% of adjusted basis of the structure. Rehab work must meet DOI standards. Carry back: 3 years. Carry forward: 10 years. No annual or per-project cap. Transfer permitted by direct transfer or disproportionate allocation. | Missouri Historic Preservation Program 573-751-7858 http://www.dnr.mo.gov/shpo/TaxCrds.htm |
| Montana | Income-producing certified historic properties automatically receive 5% state tax credit if the property qualifies for the 20% federal credit. Carry forward: 7 years. | Montana State Historic Office 406-444-7715 www.his.state.mt.us |
| New Mexico | 50% of rehab costs for all properties listed in the State Register of Cultural Properties. Also applies to stabilization and protection of archeological sites listed in the State Register of Cultural Properties. No annual statewide cap. Per-project cap: \$25,000 outside an Arts and Cultural District; \$50,000 located within an Arts and Cultural District. DOI standards apply. Carry forward: 4 years. Pre-approval required. | New Mexico Historic Preservation Division 505-827-6320 http://www.nmhistoricpreservation.org/PROGRAMS/creditsloans_taxcredits.htm |
| New York | Credit equal to 30% credit of the federal credit value (approximately 6% of the rehab cost) for commercial properties receiving federal rehab credit. 20% credit for eligible residences listed on the State or National Register and located in federally-recognized distressed census tracts. Cap: \$100,000 per commercial project; \$25,000 per residential project with a minimum \$5,000 investment. Carry forward: unlimited. Residential credit requires municipal authorization. Pre-approval and completed work certification required. New York State Historic Barns Tax Credit: 25% rehab credit for historic barns. Must be income-producing, built or placed in agricultural service before 1936 and rehab cannot “materially alter the historic appearance.” | NYS Historic Preservation Office 518-237-8643 http://nysparks.state.ny.us/shpo/ |

| State | State Income Tax Credit | Contact |
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| North Carolina | 30% credit for historic homeowners and 20% for income-producing properties. Minimum investment for 30% credit: \$25,000. Credit must be taken in 5 equal annual installments. Carry forward: 5 years. Minimum investment for commercial: same as federal credit. State tax credit of 30% or 40%, depending on location, for rehabilitating historic industrial buildings. | North Carolina Historic Preservation Office 919-733-4763 http://www.hpo.dcr.state.nc.us/tchome.htm |
| North Dakota | 25% credit for eligible historic property that is part of a Renaissance Zone Project. Project cap of \$250,000. Carry forward: 5 years. | State Historical Society of North Dakota 701-328-2666 http://www.state.nd.us/hist/RehabCredits.htm |
| Ohio | 25% credit. No annual statewide or per-project dollar cap. Cap: 100 projects per year for two years through June 30, 2009. Applications accepted in the order filed; only projects that will result in a net gain in state and local taxes will be approved and ODOD must determine that the tax credit is a major factor in applicant's decision to rehabilitate the building or increase the level of investment in the building. Pre-approval of work required; DOI Standards for Rehabilitation apply. Fully refundable. | Ohio Historic Preservation Office 614-298-2000 www.ohiohistory.org/resource/histpres |
| Oklahoma | 20% income tax credit for all eligible commercial and rental residential properties that qualify for the federal tax credit. Minimum investment: same as federal credit. No statewide or per-project caps. Carry forward: 10 years. Freely transferable for 5 years. | Oklahoma State Historic Preservation Office 405-522-4484 www.okhistory.org/shpo/shpom.htm |
| Rhode Island | 30% credit for income-producing projects. Minimum investment must exceed 50% of adjusted basis of structure. No yearly cap, and no project cap. Freely transferable. Carry forward: 10 years. 20% credit for owner-occupied residential. Minimum investment: \$2,000. Maximum credit allowable per-project per year: \$2,000. Unused credits may be carried forward as long as property maintained. Interior work ineligible for owner-occupied residences. State register properties qualify. | Rhode Island Historical Preservation & Heritage Commission http://www.preservation.ri.gov/credits/ |
| South Carolina | 10% credit for commercial properties eligible for federal credit; 25% for other eligible properties. Minimum investment for non-commercial properties: \$15,000. All credits must be taken in 5 equal annual installments. No statewide or per-project dollar caps. Pass-through entities (other than "S" corporations) may transfer credit by means of disproportionate allocation. Credits for owner-occupied residences limited to one per structure each 10 years. Pre-approval required. | South Carolina Department of Archives and History 803-896-6100 http://www.state.sc.us/scdah/hpfinancialinc.htm |
| Utah | 20% credit for residential owner-occupied and non-owner-occupied. Cap: none. Minimum investment: \$10,000 over 3 years. DOI standards apply. No fees. | Utah State Historical Society 801-533-3500 http://history.utah.gov/historic_preservation/financial_assistance/index.html |
| Vermont | All credits limited to commercial buildings located in designated downtowns or village centers. 10% credit for projects approved for federal credit. 25% credit for facade improvement projects, limited to \$25,000 per project. 50% credit for certain code improvement projects, with maximum credit of \$50,000. 9-year carry-forward. Credits may be transferred to bank in exchange for cash or interest rate reduction. Annual total program cap: \$1.5 million. | Vermont Division for Historic Preservation 802-828-3211 http://www.historicvermont.org/financial/credits.html |
| Virginia | 25% for commercial and owner-occupied residential properties. Reconstruction and improvements must amount to at least 25% of the assessed value for owner-occupied buildings and at least 50% for non-owner-occupied buildings. Carry forward: 10 years. National and state register properties eligible. DOI standards apply. No caps. Transfer by disproportionate allocation permitted. | Virginia Department of Historic Resources 804-367-2323 http://www.dhr.virginia.gov/tax_credits/tax_credit.htm |
| West Virginia | 10% credit for buildings eligible for federal credit; 20% credit for eligible owner-occupied residences. Commercial buildings entitled to same carry-back and carry-forward provisions as are available for federal credit. Owner-occupied residences entitled to 5-year carry forward. Both commercial credits and homeowner credits may be directly transferred or transferred by disproportionate allocation. Minimum investment in homeownership projects: 20% of assessed value. No statewide or per project dollar caps. | West Virginia Historic Preservation Office 304-558-0220 http://www.wvculture.org/shpo/tcresoverview.html |
| Wisconsin | 25% credit for owner-occupied residential properties. Per-project cap: \$10,000. Minimum investment: \$10,000 over 2 years; extendable to 5 years. 5% credit for commercial properties, not subject to statewide or per-project caps. Minimum investment: expenses equal to building's adjusted basis. | State Historical Society of Wisconsin 608-264-6490 http://www.wisconsinhistory.org/hp/architecture/index.asp |

State Tax Incentives Are a Proven Economic Development Tool

Rhode Island enacted a state historic preservation tax credit in 2002. Owners of historic commercial properties can earn state income tax credits equal to 30 percent of qualified rehabilitation expenditures. A recent study, commissioned by Grow Smart Rhode Island on behalf of the 57-member Coalition for Neighborhood & Economic Renewal, has shown that the state tax incentive is returning historic properties to municipal tax rolls, generating employment and housing where they are most needed, and leveraging substantial private investment. The study concludes that the state multi-year investment in the tax credit, estimated at \$460.16 million is generating a total of \$2.46 billion in economic activity. The program is estimated to add \$766.9 million to the tax base of local communities and to generate on a present value basis \$297.6 million in additional property tax revenue and \$84.2 million in sales and income tax revenue. Visit www.growsmartri.com to download the full study which updates a March 2005 report.

The Federal Penalty

Unlike the federal tax credit, which is not taxed by the federal government, the state tax credit is always worth less than its face value after federal law is taken into account.

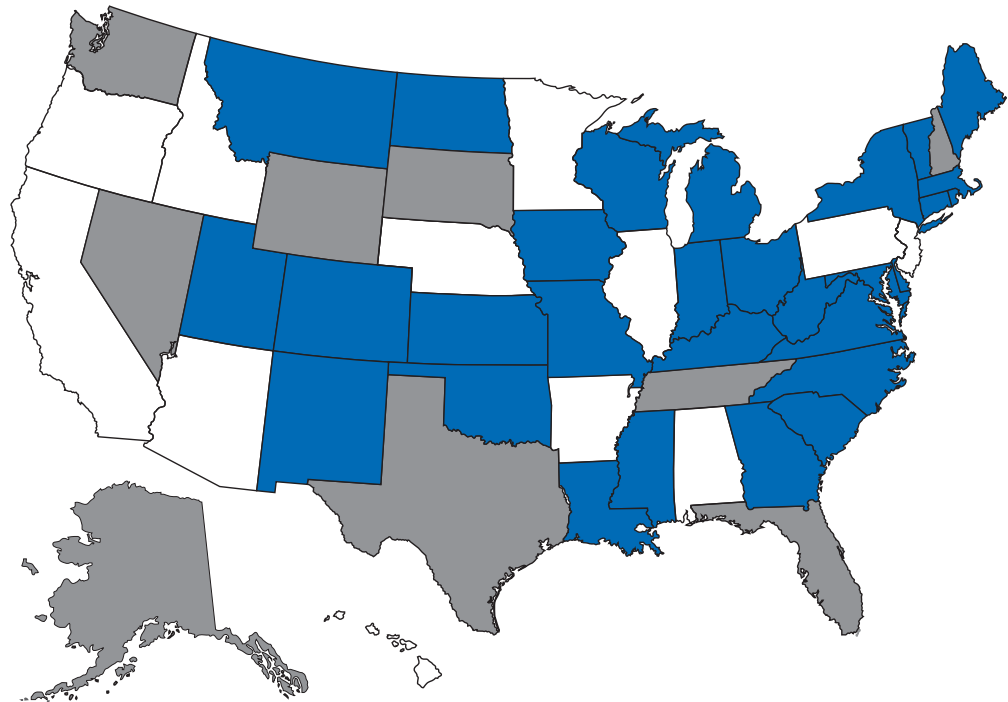
These hidden costs occur for one of two reasons:

1. State tax credit certificates, when transferred upon completion of the project, trigger a short-term capital gain to the seller, typically taxed at a 35 percent rate.

2. A party that uses a state tax credit to reduce its state tax liability normally loses the ability to take a deduction for the state tax paid with the use of the state historic tax credit. Depending on the tax bracket of the party, the loss of the deduction can reduce the value of the state tax credit by up to 35 percent.

This means that \$100 worth of federal historic tax credits is worth \$100. Yet \$100 worth of state tax credits would normally not be worth more than \$65. In practice, when credits are sold, federal credits may bring as much as \$.95 on the dollar, while the after-tax value of the state tax credits tends to be in the range of \$.55 on the dollar.

- States with income tax credits
- States that do not tax income
- States without rehab tax credits



DEFINITIONS:

CARRY BACK — the ability to apply current tax credits against state income taxes due in preceding years.

CARRY FORWARD — the ability to apply current tax credits against taxes due in future years.

CLG (certified local government) — a local government certified by the state historic preservation officer as having the capacity to administer historic preservation programs, including grants under the National Historic Preservation Act.

DISPROPORTIONATE ALLOCATION — a mechanism involving the use of pass-through entities by which a state tax credit can be allocated to a taxpayer within the state in which the project is located, while the federal tax credit for the same project is allocated to an out-of-state person or entity.

FREELY TRANSFERABLE — the ability to make an outright transfer or assignment of the tax credit to another person or entity.

SECRETARY OF THE INTERIOR'S STANDARDS FOR REHABILITATION (DOI) — general standards adopted by the Department of the Interior governing the rehabilitation of historic buildings. Rehabilitation must be carried out in accordance with these standards to qualify for federal rehabilitation tax credits for historic buildings as well as for many state tax incentives or financing programs.

RECAPTURE PERIOD — period of time during which specified action, such as a change in ownership of the property, will trigger an obligation to pay back a ratable portion of the tax credit previously claimed.

SUNSET DATE — the date on which a statutory provision will expire.