University of Baltimore Law Review

Volume 14
Issue 3 *Spring 1985*

Article 6

1985

Commments: Preserving Historic Structures: An Analysis of Regulatory Legislation and Tax Incentives in Federal, Maryland, and Municipal Law

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PRESERVING HISTORIC STRUCTURES: AN ANALYSIS OF REGULATORY LEGISLATION AND TAX INCENTIVES IN FEDERAL, MARYLAND, AND MUNICIPAL LAW

Preservation of historic resources allows society to maintain its cultural identity for future generations by providing a link to its past. In this comment, the author analyzes the federal protection afforded historically significant property, examines the available tax incentives for the rehabilitation of historic structures, and reviews state and local efforts in Maryland to preserve historically significant structures. The author concludes that tax incentives in tandem with state and local regulation constitute the most effective means of preserving historic resources.

I. INTRODUCTION

The preservation of historic landmarks in cities across America is a problem that affects federal, state, and local governments, as well as individual citizens within a community. For state and local governments, preservation requires a choice between a community's past and its future, between its cultural heritage and its growth and development. For the owners of historically significant property within the community, preservation laws often demand that they maintain the historic characteristics of their property. In an age where cost and space efficiency are valued above all else, historic buildings in downtown areas exist as dinosaurs - out of place among the jungle of modern sky-scrapers. Resolving the inherent tension between the old and the new thus presents a challenge to legislatures throughout the country.

The United States Congress has attempted to meet this challenge by c affording protection to historic structures in two ways: by enacting the National Historic Preservation Act of 1966 (NHPA), and by creating tax incentives under the current Internal Revenue Code. Maryland has followed the federal government's lead by creating its own tax incentive programs. In addition, Maryland has authorized local governments within the state to participate in the protection of historic resources by empowering counties and municipalities to enact historic area zoning ordinances.

This comment examines the protection afforded to historic structures under NHPA. The discussion then considers the tax incentives under the current Internal Revenue Code. Finally, the comment reviews state and local protection of historic structures, focusing on Baltimore City. The comment concludes that state and local regulation of historic structures, combined with federal and state tax incentives that encourage historic preservation, provide an effective means of preserving our nation's historic structures.

II. PRESERVATION OF HISTORIC RESOURCES UNDER FEDERAL LAW

A. The National Historic Preservation Act of 1966

Before 1966, federal laws protecting our nation's historic resources lacked a comprehensive framework. Federal protection consisted of the acquisition of a few individual park sites;[1] some landmarks of national significance;[2] the protection of "antiquities" on federal property;[3] a 1933 survey of structures of historical and architectural significance;[4] the founding of a nonprofit "National Trust" to encourage private preservation;[5] and the creation of an historic district in Georgetown.[6]

With the passage of NHPA in 1966,[7] Congress demonstrated an acute awareness of the need for a long-term commitment to protect historic resources. In enacting NHPA, Congress declared that "the historical and cultural foundations of the Nation should be preserved as a living part of our community life and development in order to give a sense of orientation to the American people."[8]

1. The National Register of Historic Places

NHPA authorizes the Secretary of the Interior to expand and maintain a National Register of Historic Places including "districts, sites, buildings, structures, and objects significant in American history, architecture, archaeology, engineering, and culture."[9] The Secretary of the

1. *See, e.g.*, Act of Dec. 27, 1894, ch. 12, § 1, 28 Stat. 597, 597 (current version at 16 U.S.C. § 430f (1982)) (establishing Shiloh National Military Park); Act of Mar. 2, 1933, Pub. L. No. 72-409, 47 Stat. 1421, 1421 (current version at 16 U.S.C. § 409 (1982)) (establishing Morristown National Historic Park).
2. Historic Sites, Buildings, and Antiquities Act, Pub. L. No. 74-292, 49 Stat. 666, 666 (1935) (current version at U.S.C. §§ 461-67 (1982)).
3. Antiquties Act of 1906, Pub. L. No. 59-209, 34 Stat. 225, 225 (current version at 16 U.S.C. §§ 431, 432-33 (1982)).
4. The Historic American Buildings Survey was created without specific statutory authorization as a program of the National Park Service. *See* Peterson, *Thirty Years of HABS*, AM. INST. ARCHITECTS J., Nov. 1963, at 83.
5. Act of Oct. 26, 1949, Pub. L. No. 81-408, 63 Stat. 927, 927 (current version at 16 U.S.C. §§ 468-68d (1982)) (establishing the National Trust for Historic Preservation in the United States).
6. Act of Sept. 22, 1950, Pub. L. No. 81-808, 64 Stat. 903, 903-04 (current version at D.C. CODE ANN. § 5-1101 (1981)).
7. Pub. L. No. 89-665, 80 Stat. 915 (codified as amended at 16 U.S.C. §§ 470 to 470w-6 (1982)). For the legislative history of the National Historic Preservation Act of 1966 (NHPA), see 1966 U.S. CODE CONG. & AD. NEWS 3307.
8. National Historic Preservation Act of 1966, Pub. L. No. 89-665, § 1, 80 Stat. 915, 915 (codified at 16 U.S.C.A. § 470(b)(2) (West Supp. 1984)).
9. 16 U.S.C. § 470a(a)(1)(A) (1982). NHPA was preceded by the Historic Sites, Buildings, and Antiquities Act, ch. 593, 49 Stat. 666 (1935) (current version at 16 U.S.C. §§ 461-67 (1982)), which established a policy of preserving historic resources of national significance. Under the 1935 Act, the Secretary of the Interior administers the National Historic Landmarks program and is responsible for the listing of properties designated as National Historic Landmarks on the National Register of Historic Places. To be considered a National Historic Landmark, the property

Interior has delegated the authority and the responsibility for administering the National Register program to the National Park Service, a bureau of the Department of Interior.[10] In addition to the National Register's function as the nation's central inventory of cultural resources,[11] it is the primary means of determining the property's eligibility for federal protection under NHPA,[12] as well as its eligibility for state and local protection.[13] In order to qualify for listing on the National Register, the property must be deemed "significant."[14] The National Park Service's broad definition of the term "significant" is intended to encompass a wide spectrum of cultural values.[15]

Properties are added to the National Register in one of the following ways: (1) a congressional act or an executive order that creates an historic area of the National Park System, some or all of which may be determined to have historical significance consistent with Congress's intent; (2) designation by the Secretary of Interior as a National Historic Landmark because of the property's national significance; (3) nomination under a state historic preservation program; (4) nomination by any person or local government in a state without an historic preservation program; and (5) nomination of federal property by a federal agency.[16]

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must "possess exceptional value or quality in illustrating or interpreting the heritage of the United States. . . ." 36 C.F.R. § 65.4 (1984). A property need not qualify as a National Historic Landmark in order to be included on the National Register of Historic Places. All National Historic Landmarks, however, are listed on the National Register. 16 U.S.C.A. § 470a(a)(1)(B) (West Supp. 1984).

10. 36 C.F.R. § 60.3(h) (1984). The National Park Service assumed the responsibility for administering the federal preservation program from the now defunct Heritage Conservation and Recreation Service in 1981. 46 Fed. Reg. 34,329 (1981).
11. 36 C.F.R. § 60.2 (1984). The Department of Interior ceased publishing the National Register in its entirety in 1979 and began to publish only annual supplements containing all new additions to the National Register. For a cumulative listing of all properties on the National Register, see 44 Fed. Reg. 7,416 (1979); 45 Fed. Reg. 17,446 (1980); 46 Fed. Reg. 10,622 (1981); 47 Fed. Reg. 4,932 (1982); 48 Fed. Reg. 8,626 (1983); 49 Fed. Reg. 4,608 (1984).
12. *See infra* notes 22-24 and accompanying text.
13. *See infra* notes 146-48 and accompanying text.
14. 16 U.S.C. § 470a(a)(1)(A) (1982).
15. 36 C.F.R. § 60.4 (1984).

    > The quality of significance in American history, architecture, archeology, engineering, and culture is present in districts, sites, buildings, structures, and objects that possess integrity of location, design, setting, materials, workmanship, feeling, and association and
    > (a) that are associated with events that have made a significant contribution to the broad patterns of our history; or
    > (b) that are associated with lives of persons significant in our past; or
    > (c) that embody the distinctive characteristics of a type, period, or method of construction, or that represent the work of a master, or that possess high artistic values, or that represent a significant and distinguishable entity whose components may lack individual distinction; or
    > (d) that have yielded, or may be likely to yield, information important in prehistory or history.

    Id. § 60.4(a)-(d) (1984).
16. *Id.* § 60.1(b)(1)-(5) (1984).

The listing of property on the National Register does not prohibit actions by the private property owner in relation to the property,[17] but instead is used as a planning tool for identifying historic resources.[18] In 1980 NHPA was amended to require that states provide a notice and comment period in the event that a property owner objects to the listing of his property on the National Register.[19] Most property owners, however, welcome the listing of their property because of the substantial tax advantages available to listed property[20] and because of the property's eligibility for federal assistance.[21]

2. Protection of Historic Resources Under NHPA

Through the National Register of Historic Places, NHPA established a vehicle for identifying America's historic resources. Once these resources have been identified, however, NHPA fails to provide the substantive protection necessary to preserve the property's historic features.

The procedural requirements contained in section 106[22] of NHPA are the sole protection available to historic property under the Act. This section attempts to protect historic resources from the adverse effects of "undertakings"[23] by imposing certain procedures upon the federal agency involved with the project.[24]

If a federal agency has direct or indirect jurisdiction over a proposed federal, federally-assisted, or federally licensed undertaking that would affect an historic site or structure, then section 106 requires that the agency head "take into account the effect of the undertaking" upon the property and "afford the Advisory Council on Historic Preservation . . . a reasonable opportunity to comment with regard to such undertaking."[25] The agency is also required to minimize the adverse conse-

17. *Id.* § 60.2.
18. *Id.* § 60.2(a).
19. *Id.* § 60.6(c). As part of the nomination process, the state is required to notify in writing each owner of the property. The written notice must be sent at least 30 days but not more than 75 days before the State Review Board meeting. The notice gives the property owners at least 30 days but not more than 75 days to submit written comments and concur in or object to the nomination of such property. *Id.*
20. See *infra* notes 39-98, 159-68 and accompanying text for a discussion of federal and Maryland tax incentives for Historic Preservation.
21. 16 U.S.C. § 470a(d)(1) (1982). NHPA provides for a program of matching grant-in-aid to the states for historic preservation programs. The statute also authorizes the federal government to provide matching funds to the National Trust for Historic Preservation in the United States. *Id.* § 470a(d)(2). Although the Reagan Administration requested zero funding for preservation programs in 1985, Congress reinstated federal funds in the amount of $4.4 million for the National Trust and $21 million to the state historic preservation offices. Preservation News, Nov. 1984, at 2, col. 3.
22. National Historic Preservation Act of 1966, § 106, 16 U.S.C. § 470f (1982).
23. "Undertaking" is defined as "any federal, federally-assisted or federally licensed action, activity, or program or the approval, sanction, assistance, or support of any non-federal action, activity or program." 36 C.F.R. § 800.2(c) (1984).
24. National Historic Preservation Act of 1966, § 106, 16 U.S.C. § 470f (1982).
25. 36 C.F.R. § 800.2(c) (1984).

quences of the project upon the property by consulting and negotiating with the State Historic Preservation Officer (SHPO)[26] and the Advisory Council.[27]

Under the procedural scheme outlined in section 106, the federal agency, with the assistance of the SHPO, identifies any eligible property located within the proposed project's environmental impact area, whether or not the property is listed on the National Register.[28] The parties then determine whether the project will have an effect[29] upon the property, and if so, whether that effect will be detrimental.[30] If either the federal agency or the Advisory Council's executive director finds that the effect will be adverse, then the federal agency is required to allow the Advisory Council the opportunity to comment.[31] The agency official, the SHPO, and the executive director of the Advisory Council then meet "to consider . . . alternatives to the undertaking that could avoid, mitigate, or minimize [the] adverse effects. . . ."[32] A Memorandum of Agreement is issued if the parties agree on a plan to avoid the project's adverse effects.[33] If an agreement cannot be reached, however, then the Advisory Council may meet to consider the proposed project and may issue written comments to the agency.[34] After the agency has made a final decision concerning the project, the agency submits a written report to the Advisory Council describing the action taken in response to the com-

26. The State Historic Preservation Officer is the official within each state who has been designated by the Governor or chief executive of the state to administer the historic preservation fund program within the state. *Id.* § 61.2(p).
27. *Id.* § 800.6(b).
28. "Area of the undertaking's potential environmental impact" means "that geographic area within which direct and indirect effects generated by the undertaking could reasonably be expected to occur and thus cause a change in the historical, architectural, archaeological, or cultural qualities possessed by a National Register or eligible property." *Id.* § 800.2(o).
29. An effect occurs when "an undertaking changes the integrity of location, design, setting, materials, workmanship, feeling, or association of the property that contributes to its significance in accordance with the National Register criteria." *Id.* § 800.3(a).
30. *Id.* § 800.4(d) (adverse effect determination). Some conditions that constitute an "adverse effect" are:
    (1) Destruction or alteration of all or part of a property;
    (2) Isolation from or alteration of the property's surrounding environment;
    (3) Introduction of visible, audible, or atmospheric elements that are not of character with the property or alter its setting;
    (4) Neglect of a property resulting in its deterioration or destruction;
    (5) Transfer or sale of a property without adequate conditions or restrictions regarding preservation, maintenance, or use.
    Id. § 800.3(b).
31. *Id.* § 800.4(e). Until the Advisory Council issues its comments, the agency is prohibited from taking any action that could have an adverse effect upon the property. *Id.*
32. *Id.* § 800.6(b).
33. *Id.* § 800.6(b)(5).
34. *Id.* § 800.6(b)(7),(d)(5).

ments and explaining the effect that such action will have on the historic resource.[35] This report evidences compliance by the agency with the provisions of section 106.[36]

Section 106 does not require the agency to follow the recommendations of the Advisory Council. Although a project may be enjoined until the agency complies with section 106's procedural requirements,[37] the Advisory Council does not possess the authority to alter or modify projects that have an adverse impact upon a historic site or structure. The limited role of the Advisory Council under section 106 constitutes the major flaw in NHPA's attempt to provide historic resources with protection from the adverse effects of undertakings. Once an adverse effect has been established, the recommendations of the Advisory Council should be followed.

Another weakness of NHPA is that it does not prohibit the owner of property listed on the National Register from destroying or dismantling the historic structure.[38] Section 106 contains NHPA's sole restriction on actions adversely affecting National Register property. This restriction, however, does not protect the historic property from all adverse actions, only those adverse effects in which the federal government is involved. Thus, NHPA allows the owner of historic property to destroy the historic aspects of the property if he so desires.

B. Federal Tax Incentives for Historic Preservation

Since their introduction in 1976, federal tax incentives in the Internal Revenue Code (Code) that encourage historic preservation have emerged as an effective means of promoting the rehabilitation of historic resources. Although the initial purpose of the changes in the tax law was simply to offset existing Code biases in favor of new construction,[39]

35. *Id.* § 800.6(d)(7).
36. *Id.*
37. Morris County Trust for Historic Preservation v. Pierce, 714 F.2d 271 (3rd Cir. 1983); National Trust for Historic Preservation in the U.S. v. United States Army Corps of Eng'rs, 552 F. Supp. 784 (S.D. Ohio 1982); *cf.* District of Columbia Fed'n of Civic Ass'ns v. Adams, 571 F.2d 1310 (4th Cir. 1978) (court denied injunctive relief where Secretary of Transportation gave the Advisory Council an opportunity to comment on a highway project, but failed to adhere to Advisory Council's regulations before approving the construction).
38. *See* Edwards v. First Bank of Dundee, 534 F.2d 1242, 1246 (7th Cir. 1976) (appeals court dissolved a district court order that restrained the defendant from demolishing a privately owned building, finding § 106 of NHPA inapplicable in the absence of federal funding or assistance).
39. 122 CONG. REC. 24,320 (1976) (remarks of Sen. Beall). Prior to the Tax Reform Act of 1976, the Internal Revenue Code favored new construction through its depreciation scheme. Although new commercial property could be depreciated at an accelerated rate, used buildings could only be depreciated using the straight line method. Section 2124 of the Tax Reform Act of 1976 sought to overcome this bias by applying the accelerated depreciation rate to the unrecovered acquisition and rehabilitation costs for rehabilitated historic structures. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2124, 90 Stat. 1525, 1919 (repealed 1981). Section 2124 also

favorable tax treatment has proven to be a catalyst for the preservation movement.[40]

1. Investment Tax Credits for Rehabilitation Expenditures

Buildings and their structural components generally do not qualify for investment tax credits.[41] Nevertheless, to help revitalize the economic prospects of urban areas and to encourage the preservation of historic structures, Congress has provided investment tax credits for the cost of rehabilitating older nonresidential buildings and Certified Historic Structures (CHS).[42] Under Code section 48(g)(3), a CHS is defined as "any building (and its structural components) which . . . is listed in the National Register, or . . . is located in a registered historic district and is certified by the Secretary of the Interior . . . as being of historic significance to the district."[43]

The Economic Recovery Tax Act of 1981 (ERTA)[44] introduced a revised system[45] of investment tax credits to stimulate economic growth in urban areas and to promote the goals of historic preservation. Under ERTA's three-tier scheme, the amount of the tax credit allowed for rehabilitation expenditures is determined by either the age of the structure or

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made available an alternative five-year amortization option for rehabilitation expenditures. *Id.* The five-year amoritization option was selected by 95 percent of those investors that exercised one of the two methods. Note, *Government Incentives for Historic Preservation*, 37 NAT'L TAX J. 113, 118 n.6 (1984). These sections were subsequently repealed by the Economic Recovery Tax Act of 1981 (ERTA). Pub. L. No. 97-34, § 212(d)(1), 95 Stat. 172, 239. The Code currently provides that expenditures do not constitute "qualified rehabilitation expenditures" unless the straight line method of depreciation is employed. I.R.C. § 48(g)(2)(B)(i) (1982).

40. The investment tax credit has made it very attractive for investors to rehabilitate historic buildings for rental housing, offices, and commercial uses. For example, in 1983 alone over 200 rehabilitation projects in Maryland qualified for the 25 percent investment tax credit. These projects represented more than $100 million in private rehabilitation investment and created more than 1500 new housing units in previously abandoned or deterioated historic structures. 1983 MD. HIST. TR. ANN. REP. 8.
41. I.R.C. § 48(a)(1)(B) (1982).
42. S. REP. NO. 144, 97th Cong., 1st Sess. 72, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 108, 177.
43. I.R.C. § 48(g)(3)(A) (1982). A "Registered Historic District" is any district: (1) listed in the National Register of Historic Places or (2) designated by appropriate state or local statute, provided that the Secretary of the Interior certifies that the statute will substantially achieve its purpose of preservation and rehabilitation, and that the district meets substantially all the requirements for listing in the National Register. *Id.* § 48(g)(3)(B).
44. Pub. L. No. 97-34, 95 Stat. 172 (1981). For a concise discussion of the tax incentives made available under ERTA, see Whitebread, *Tax Incentives for the Preservation of Historic Properties*, 60 TAXES 446 (1982).
45. The 1978 Revenue Act included "qualified rehabilitated buildings" in the list of properties eligible for an investment tax credit, thus making applicable the 10 percent credit under Code section 46(a). The Revenue Act of 1978, Pub. L. No. 95-600, § 315, 92 Stat. 2763, 2828. ERTA increased the investment tax credit available for qualified rehabilitation expenditures. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 212, 95 Stat. 172, 256 (codified at I.R.C. § 46(b)(4)(A) (1982)).

the structure's status as a CHS.[46] The three-tier scheme provides a fifteen percent credit on expenditures made on structures at least thirty years old, a twenty percent credit on expenditures made on structures at least forty years old, and a twenty-five percent credit on expenditures made on a CHS.[47]

To be eligible for an investment tax credit, the structure must fall within the Code's definition of a "qualified rehabilitated building."[48] Under section 48(g)(1), the definition of "qualified rehabilitated building" establishes certain requirements as to the nature and extent of the rehabilitation work. The structure must retain most of the external characteristics that made it of historic value.[49] That is, the structure cannot merely *look* historic, it must *be* historic by retaining its historic qualities. Unless these requirements are met, the structure cannot qualify for the investment tax credit.

In addition to the requirements placed on the structure itself, the rehabilitation expenditures incurred must meet certain criteria to qualify for the credit.[50] The expenditures must be capitalized[51] and must be incurred for real property with an eighteen year recovery period.[52] Section 48(g)(2)(B) expressly excludes certain expenditures from eligibility for the credit.[53] For example, acquisition costs[54] and costs attributable to enlargement of a structure[55] are ineligible. Likewise, if straight-line de-

46. I.R.C. § 46(b)(4)(A) (1982).
47. *Id.*
48. *Id.* § 48(g)(1)(A). All "qualified rehabilitated buildings" are treated as new section 38 property, and thus the applicable tax credits are not affected by the section 48(c) limitations imposed on used section 38 property. *Id.* § 48(g)(4).
49. *Id.* § 48(g)(1)(A)(i)-(iii). Subsection (iii) requires that a "qualified rehabilitated building" retain 75 percent or more of the structure's existing external walls. *Id.* § 48(g)(1)(A)(iii). The Deficit Reduction Act of 1984, however, added subparagraph E to section 48(g)(1). Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 1043(a), 98 Stat. 494, 1044 (codified at I.R.C. § 48(g)(1)(E) (West Supp. 1984)). Subparagraph E provides an alternate means of satisfying the wall retention requirement. This alternative test requires that:

> (i) 50 percent or more of the existing external walls of the building are retained in place as external walls,
> (ii) 75 percent or more of the external walls of such buildings are retained in place as internal or external walls, and
> (iii) 75 percent or more of the existing internal structural framework of such building is retained in place.

I.R.C. § 48(g)(1)(E) (West Supp. 1984).
50. I.R.C. § 48(g)(2) (1982).
51. *Id.* § 48(g)(2)(A). The term "capitalize" means to convert a periodical payment into an equivalent capital sum or sum in hand. BLACK'S LAW DICTIONARY 191 (rev. 5th ed. 1979).
52. I.R.C. § 48(g)(2)(A)(i) (1982). The 18 year recovery period is reduced to 15 years for low income housing projects. *Id.* Section 168 requires that the cost of property be written off over statutory "recovery periods," rather than individual useful lives. *Id.* § 168(b).
53. *Id.* § 48(g)(2)(B).
54. *Id.* § 48(g)(2)(B)(ii).
55. *Id.* § 48(g)(2)(B)(iii).

preciation is not used with respect to the rehabilitation expenditures, then the expenditures do not qualify for the credit.[56]

The tax credit scheme is aimed at assisting property owners who have undertaken major rehabilitation efforts to preserve the historic features of their property. Thus, section 48 requires that the structure be "substantially rehabilitated"[57] to be eligible for the credit. The term "substantially rehabilitated" means that the rehabilitation expenditures incurred during a limited period must exceed the greater of the taxpayer's adjusted basis in the property, or $5,000.[58]

Certain requirements under the Code vary depending upon whether the "qualified rehabilitated building" constitutes a CHS, qualifying for the twenty-five percent credit, or instead constitutes property eligible for the fifteen or twenty percent credit. Generally, the Code requires that property be placed in service at least thirty years prior to the date on which the rehabilitation work began.[59] Section 48(g)(1)(B), however, specifically excludes a CHS from this proscription, and allows such a structure to be eligible for the credit without reference to the date in which it was placed in service.[60]

Although a CHS is not subject to the thirty year in-service requirement, the Code stipulates that all rehabilitation work performed on a CHS be certified by the Secretary of the Interior.[61] To be certified, the rehabilitation work must be consistent with the historic character of the building or the historic district in which the building is located.[62] For a structure that qualifies for either the fifteen or the twenty percent credit, but is not a CHS, there is no requirement that any rehabilitation work be certified.[63]

As a general rule, after rehabilitation, the structure must be used for

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56. *Id.* § 48(g)(2)(B)(i).
57. *Id.* § 48(g)(1)(A)(i).
58. *Id.* § 48(g)(1)(C). The "substantially rehabilitated" test requires that the expenditures over a 24 month period must at least equal the taxpayer's basis in the building, and must not be less than $5,000. *Id.* A special rule, extending the 24 month period to 60 months, applies if the rehabilitation is expected to be completed in phases as set forth in architectural plans submitted before the rehabilitation begins. *Id.* § 48(g)(1)(C)(ii); *see* Proposed Treas. Reg. § 1.48-11(b)(7) (1980).
59. I.R.C. § 48(g)(1)(B) (1982).
60. *Id.*
61. *Id.* § 48(g)(2)(B)(iv); *see also id.* § 48(g)(2)(C) (defining the term "certified rehabilitation").
62. *Id.* § 48(g)(2)(C).
63. *Id.* § 48(g)(2)(B)(iv)(I). The distinction in certification requirements is probably attributable to the different policies advanced by tax credits for CHS's and non CHS's. CHS tax credits are given to encourage the preservation of historic structures, and, as such, government supervision is necessary to ensure that the structures retain their historic features. On the other hand, credits available for structures not meeting the criteria for CHS status are given to promote the rejuvenation of older downtown business districts, and, thus require no government certification. *See* S. REP. NO. 144, 97th Cong., 1st Sess. 69, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 108, 174.

nonresidential purposes.[64] As an exception to this requirement, a CHS may be rehabilitated for income-producing residential use.[65]

Before claiming any of the three available tax credits, a taxpayer should consider all of the consequences of the rehabilitation tax credit. One consideration for the taxpayer is that the structure's basis must be adjusted to reflect the tax credit.[66] If the fifteen percent or the twenty percent credit is taken, then the depreciable basis of the rehabilitation expenditures must be reduced by the full amount of the credit.[67] In contrast, if the structure qualifies as a CHS, which is eligible for the twenty-five percent credit, then the structure's basis is reduced by fifty percent of the tax credit earned.[68]

The fifty percent basis reduction rule applicable to a CHS may hinder, rather than promote, the purposes of NHPA because the rule discourages owners of historic property from qualifying the structure as a CHS.[69] Combined with the cost of certifying rehabilitation work on a CHS,[70] the basis reduction rule removes much of the incentive to take the twenty-five percent credit as opposed to the fifteen or twenty percent credit.

Instead of removing the incentive for the twenty-five percent credit,

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64. I.R.C. § 48(a)(3) (1982); Treas. Reg. § 1.48-1(h) (1964).

65. To be eligible for an investment tax credit, a structure generally must be depreciable. I.R.C. § 48(a)(1) (1982). Property is depreciable if it is either used in the taxpayer's trade or business or held for the production of income. *Id.* § 167(a)(1)-(2). Although residential property may often be income-producing (for example, apartment buildings) and thus depreciable, section 48(a)(3) prohibits property used primarily to furnish lodging from qualifying for an investment tax credit. *Id.* § 48(a)(3). Section 48(a)(3)(D), however, excludes CHS's from this prohibition. Therefore, an income-producing residential CHS may qualify for the 25 percent investment tax credit. A CHS that is used partially for residential purposes and partially for commercial purposes should qualify for the credit on a pro rata basis. *See* Treas. Reg. § 1.48-1(h)(2)(i) (1964).

66. *See* I.R.C. § 48(q)(1) (West Supp. 1984). As previously noted, to qualify for the tax credit the taxpayer must depreciate the rehabilitation expenditures using the straight line method. *Id.* § 48(g)(2)(B)(i); *see also supra* note 56 and accompanying text.

67. *See* I.R.C. § 48(g)(1),(3) (West Supp. 1984). Section 48(q)(1) provides in general that the basis of property eligible for an investment tax credit must be reduced by 50 percent of the credit. *Id.* § 48(q)(1). Section 48(q)(3), however, establishes a special rule for qualified rehabilitated buildings other than a CHS. This rule requires that the basis of such buildings be reduced by the full amount of the credit. *Id.* § 48(q)(3).

68. *Id.* § 48(q)(1). As originally enacted under ERTA in 1981, the rehabilitation tax scheme contained no basis reduction requirement applicable to a CHS. *See* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 212, 95 Stat. 172, 238. With the enactment of the Tax Equity and Fiscal Responsibility Act of 1982, Congress required a basis reduction of 50 percent of the tax credit earned for a CHS. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 205, 96 Stat. 324, 427-28 (codified at I.R.C. § 48(q)(1) (West Supp. 1984)).

69. *See* Whitebread, *Historic Preservation Tax Incentives — The Impact of Recent Legislation*, 61 TAXES 243, 246 (1983).

70. *See* 36 C.F.R. § 67.12 (1984) (setting forth the fees for processing rehabilitation certification requests).

the Code should encourage a property owner to qualify his structure as a CHS because the rehabilitation work on a CHS must be certified by the Department of Interior.[71] This requirement ensures the work will be consistent with the historic characteristics of the property. The absence of project review for structures qualifying for the fifteen and twenty percent credit may result in the loss of many of the structure's historic components.

Another factor to consider before deciding to claim a rehabilitation tax credit is the effect of the alternative minimum tax.[72] This tax may have a dramatic effect on many rehabilitation projects, especially where the credit earned is substantial. For a taxpayer other than a corporation,[73] the alternative minimum tax is computed by applying a flat twenty percent tax on the alternative minimum taxable income that exceeds an exemption amount.[74] The additional tax imposed is the excess of the alternative minimum tax over the individual's regular income tax for the year.[75] Unlike regular income tax, however, the alternative minimum tax may not be offset by any nonrefundable tax credit, including the rehabilitation investment tax credit.[76] The application of the alternative minimum tax to rehabilitation projects is inconsistent with Congress's declared policy of promoting the rehabilitation of deteriorated inner cities and preserving historic structures.[77] When the alternative minimum tax applies, the rehabilitation investment tax credit merely masquerades as a tax benefit. If Congress is serious about revitalizing inner cities and preserving historic landmarks, it should allow the rehabilitation credit to be applied in computing the alternative minimum tax, and look elsewhere in satisfaction of its tax revenue needs.[78]

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71. *See supra* note 61 and accompanying text.
72. I.R.C. § 55(a) (1982). The tax law provides preferential treatment to many individuals and corporations who do not pay tax on certain tax-exempt income and who enjoy special deductions. Certain tax preference items, like depreciation, may reduce income that has no relationship to the deduction. To reduce the advantages derived from these preferences and to ensure that taxpayers enjoying these preferences pay a fair share of the tax burden, the law imposes a minimum tax on tax preferences. For the legislative history of the alternative minimum tax, see H.R. REP. NO. 413, 91st Cong., 1st Sess. 61, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 1645, 1724.
73. Section 55(a) does not apply to corporations. Instead, section 56 governs the imposition of additional taxes on corporations for tax preference items. I.R.C. § 56(a) (1982).
74. *Id.* § 55(a). Section 55(f) sets forth the exemption amount applicable to taxpayers subject to the alternative minimum tax. *Id.* § 55(f).
75. *Id.* § 55(a).
76. *Id.* § 55(c). Where the credit earned is substantial, the alternative minimum tax may have a dramatic impact on the amount of tax paid by a property owner. *See* Whitebread, *supra* note 69, at 246-47.
77. S. REP. NO. 144, 97th Cong., 1st Sess. 72, *reprinted in* 1981 U.S. CODE & AD. NEWS 108, 177.
78. For further criticism of the application of the alternative minimum tax with respect to the rehabilitation investment tax credit, see Whitebread, *supra* note 69, at 251. Whitebread suggests that Congress could have fulfilled its revenue raising purpose

In addition to the alternative minimum tax, property owners considering the rehabilitation investment tax credit should be aware of other limitations on its use. Under the newly created "general business credit,"[79] several tax credits, including the rehabilitation investment tax credit, are combined.[80] The maximum amount of income tax that can be offset by the general business credit during any taxable year is $25,000 plus eighty-five percent of tax liability over $25,000.[81] Unused tax credits may be carried back for three years and carried forward for fifteen years.[82] After fifteen years, any remaining unused credits are taken as a deduction.[83]

Potential tax consequences also accompany the sale or disposition of a rehabilitated property. An investment tax credit for rehabilitation expenditures is subject to recapture if the structure is disposed of within five years after the taxpayer has incurred the expenditures.[84] If the rehabilitated structure is held for less than one year, then the full amount of the credit will be recaptured.[85] Any dispositions after one year will recapture the credit at a decreasing rate of twenty percent per year.[86] If the rehabilitated structure is disposed of within five years, then fifty percent of the recaptured amount is added back to the basis of a CHS,[87] while one hundred percent is added back in the case of thirty and forty year old buildings qualifying for the fifteen and twenty percent credits, respectively.[88] Because the adjustment to basis is made immediately before disposition of the building, the basis as increased by the recaptured amount is used in determining gain or loss on disposition.[89] The upward basis adjustment restores to basis the applicable portion of the

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and accommodated the goal of inner city revitalization by allowing the alternative minimum tax to be offset by up to 50 percent of the available rehabilitation investment tax credit. *Id.*

79. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 473, 98 Stat. 494, 827-28 (codified at I.R.C. § 38 (West Supp. 1985)).
80. I.R.C. § 38(b) (West Supp. 1985). Under section 38, a taxpayer now combines his available investment tax credit (both the regular and the energy credits), targeted job credit, alcohol fuel credit, and the employee stock ownership plan (ESOP) credit into a unified general business credit. *Id.*
81. *Id.* § 38(c).
82. *Id.* § 39(a)(1).
83. *Id.* § 196 (West Supp. 1985). Section 196 allows a deduction of a portion of any rehabilitation investment tax credit to rehabilitate property other than a CHS for which a downward basis adjustment has been made if the credit remains unused after the expiration of the 15 year carry-forward period. *Id.* § 196(a). For a CHS, section 196 allows a deduction of 50 percent of any remaining investment tax credit if unused after the expiration of the 15 year carry-forward period. *Id.* § 196(a).
84. *Id.* § 47(a)(5)(A).
85. *Id.* § 47(a)(5)(B).
86. *Id.*
87. *Id.* § 48(q)(2).
88. *Id.* Section 48(q)(3), which establishes a special rule for qualified rehabilitated buildings other than a CHS, provides that the full recapture amount be added back to the basis. *Id.* § 48(q)(3).
89. *Id.* § 48(q)(2).

downward adjustment for which the taxpayer received no tax benefit because of the recapture event.[90]

2. Charitable Deduction for the Donation of a Conservation Easement

In addition to the investment tax credit, the charitable deduction allowed for the donation of a conservation easement provides further incentive for the taxpayer to invest in historic property. A conservation easement creates a permanent restriction on the use of the real property.[91] This restriction requires that the grantor-building owner, and all future owners, maintain the building's facade and refrain from damaging the historical and cultural significance connected with the facade.[92] The charitable deduction applies to any historically important land area, or any structure that is either listed on the National Register or located in a registered historic district and certified as being of historical significance to the district.[93] To be eligible for the deduction, the easement must be contributed to a "qualified organization."[94]

Generally, the amount of the deduction is the difference between the fair market value of the property before the granting of the easement and the fair market value after the easement is transferred to the grantee.[95]

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90. *See* DiMaggio, *Certified Historic Structures Still a Tax Sheltered Investment with Recent Changes*, 13 TAX. FOR LAWS. 48, 49 (1984).

91. I.R.C. § 170(h)(2)(C) (1982); *see also id.* § 170(h)(5)(A) ("A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.").

92. *See id.* § 170(h)(2)(C) (providing that "a restriction (granted in perpetuity) on the use which may be made of the real property" is a "qualified real property interest"); *id.* § 170(h)(4)(A)(iv) ("the preservation of a historically important land area or a certified historic structure" constitutes a "conservation purpose"); *see also* S. REP. 1007, 96th Cong., 2d Sess. 12, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 6736, 6748.

93. I.R.C. § 170(h)(4)(A)(iv) (1982); *see id.* § 170(h)(4)(B) (defining the term "Certified Historic Structure"). Unlike the investment tax credit provisions, section 170 does not require that the CHS be depreciable. Thus, a charitable deduction for the donation of an easement on a private residence is permitted. *See* S. REP. 1007, 96th Cong., 2d Sess. 12-13, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 6736, 6748.

94. I.R.C. § 170(h)(3) (1982). Generally, eligible recipients of conservation easements are governments, organizations controlled by government, and publicly supported charities. *See id.* To fulfill the purpose of the easement, these recipients should possess "the commitment and the resources to enforce the perpetual restrictions and to protect the conservation purposes." S. REP. 1007, 96th Cong., 2d Sess. 14, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 6736, 6749.

95. *See* Rev. Rul. 76-376, 1976-2 C.B. 53; Rev. Rul. 73-339, 1973-2 C.B. 68. This test does not lend itself to mechanical application. The legislative history to section 170 indicates Congress's awareness that the donation of an easement does not always reduce a property's fair market value: "[T]here may be instances in which the grant of an easement may serve to enhance, rather than reduce the value of property, and in such instances no deduction would be allowable; for example where there is a premium value on property of a historic nature." S. REP. 1007, 96th Cong., 2d Sess. 15, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 6736, 6750. In assessing the fair market value of the property before contribution of the easement, it is necessary

The difference represents the partial interest in the property that has been given up by the grantor. A corresponding reduction of the grantor's basis in the property accompanies the charitable deduction.[96] The basis reduction is the same percentage as the reduction in the property's fair market value.[97]

Where the property's adjusted basis is substantial, the basis reduction accompanying the donation of the easement may be advantageous to the taxpayer. For example, a CHS owner who previously refused to make rehabilitation expenditures exceeding the property's adjusted basis, and thus could not qualify for the investment tax credit because the property would not be "substantially rehabilitated," may reconsider after granting a conservation easement. The donation of the easement, by causing a reduction in basis, lowers the minimum expenditure requirement necessary to qualify for the investment tax credit.[98] The taxpayer then receives the benefit of the investment tax credit as well as the benefit of the charitable deduction.

III. STATE PROTECTION OF HISTORIC RESOURCES

A. The Constitutionality of State Historic Preservation Laws

The United States Supreme Court gave express constitutional recognition to state regulation of private property for historical preservation purposes in *Penn Central Transportation Co. v. New York City*.[99] The *Penn Central* Court decided whether a city may place restrictions on the development of individual landmarks without effecting a "taking" of property in violation of the fifth and fourteenth amendments.[100] The Court affirmed the landmark designation of Penn Central Terminal and held that the development restriction resulting from the landmark designation by New York City constituted a valid exercise of the police power.[101]

To state and local governments concerned with protecting their historic resources, the *Penn Central* holding was of vital importance. In preserving historic property, state and local governments employ one of

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to consider both the current use of the property and the likelihood that the property would have been developed absent such a restriction. Thus, historic preservation laws restricting the development of the property must be taken into account. *Id.*

96. Rev. Rul. 64-205, 1964-2 C.B. 62, 63.

97. *Id.*

98. DiMaggio, *supra* note 90, at 51. For a discussion of the relationship between basis and rehabilitation expenditures, see *supra* text accompanying notes 57-58.

99. 438 U.S. 104 (1978).

100. *Id.* at 107.

101. *Id.* at 138. Although the *Penn Central* Court held that the New York City law did not effect a taking of the owner's property, the Court carefully limited the scope of its holding to the facts at bar, emphasizing "Penn Central's present ability to use the Terminal for its intended purposes and in a gainful fashion." *Id.* at 138 n.36. Thus, the constitutionality of a landmark law depends upon the facts and circumstances of the case, requiring the court to engage in an "essentially ad hoc, factual inquir[y]." *Id.* at 124.

two methods: the power of eminent domain, or the police power.[102] Although the power of eminent domain has long been accepted,[103] the cost of compensating landmark owners precludes its widespread use.[104] Thus, states generally have employed the police power, rather than the power of eminent domain to maintain cultural and historic resources.[105]

Regulations restricting the use of property, however, are subject to the same standards employed in judging all uses of the police power.[106] If the magnitude of the restriction is too great, then the restriction may constitute a "taking"[107] within the meaning of the fifth amendment, made applicable to the states through the fourteenth amendment.[108] In

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102. For examples of cases in which courts have upheld historic landmark preservation statutes or ordinances that authorized the taking of property by eminent domain, see Roe v. Kansas, 278 U.S. 191, 193 (1929) (Court upheld state statute that extended the state's power of eminent domain to any land within the state that possesses unusual historical interest); Flaccomio v. Baltimore, 194 Md. 275, 280-81, 71 A.2d 12, 14 (1950) (court upheld city ordinance that authorized acquisition by purchase or condemnation of certain property for addition to Star Spangled Banner Flag House); *In re* Opinion of Justices, 297 Mass. 567, 570, 8 N.E.2d 753, 756 (1937) (court upheld statute authorizing city to acquire certain land and wharf as memorial to sailors). For examples of cases in which courts have upheld historic landmark preservation statutes or ordinances as a valid exercise of the government's police power, see Figarsky v. Historic Dist. Comm., 171 Conn. 198, 205, 368 A.2d 163, 169-70 (1976) (court upheld historic district ordinance as applied to owner of building that was important in maintaining character of historic district); Lafayette Park Baptist Church v. Board of Adjustment, 599 S.W.2d 61, 66 (Mo. App. 1980) (court upheld city's historic district ordinances as applied to church within a historic district for which demolition permit was denied); Santa Fe v. Gamble Skogmo, Inc., 73 N.M. 410, 415, 389 P.2d 13, 17-18 (1964) (court upheld regulation of windowpane size in alteration of buildings within a historic area under city's historic zoning ordinance). *See generally* Annot., 18 A.L.R. 4th 990 (1982 & Supp. 1984) (summarizing cases that have attacked the validity of statutes or ordinances authorizing use of the power of eminent domain or the police power).

103. *See, e.g.*, Georgia v. Chattanooga, 264 U.S. 472, 480 (1924); Albert Hanson Lumber Co. v. United States, 261 U.S. 581, 587 (1922); Adirondack Ry. v. New York, 176 U.S. 335, 346 (1899); United States v. Gettysburg Elec. Ry., 160 U.S. 668, 681 (1896).

104. *See* HENRY E. MILLS, A TREATISE UPON THE LAW OF EMINENT DOMAIN § 84, at 111-12 (1977).

105. *See, e.g.*, Maher v. New Orleans, 516 F.2d 1051 (5th Cir. 1975) (court upheld city ordinance that regulated preservation and maintenance of buildings in a historic section of New Orleans as a proper exercise of police power); Bohannon v. San Diego, 30 Cal. App. 3d 416, 106 Cal. Rptr. 333 (1973) (court upheld as a valid exercise of police power a city ordinance that created an architectural control district to preserve the area's historic aspects); Rebman v. Springfield, 111 Ill. App. 2d 430, 250 N.E.2d 282 (1969) (court upheld city zoning ordinance that created a historic district as a valid exercise of police power).

106. The Supreme Court has consistently upheld land use regulations that destroy or adversely affect recognized real property interests if the government tribunal reasonably concludes that the regulation promotes the health, safety, or general welfare. *See* Goldblatt v. Town of Hempstead, 369 U.S. 590, 594-96 (1962); Nectow v. City of Cambridge, 277 U.S. 183, 188 (1928); Village of Euclid v. Ambler Realty Co., 272 U.S. 365, 391 (1926).

107. Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922).

108. *See* Chicago, B. & Q. R.R. Co. v. Chicago, 166 U.S. 226, 239 (1897).

determining the amount of interference necessary to constitute a "taking," several tests have emerged.[109]

The simplest test maintains that whenever private property is physically invaded by the government, a taking has occurred.[110] The concept of physical invasion by the government appears to have been envisioned by the framers of the Constitution when the fifth amendment was drafted.[111] Although the simplicity of a physical invasion test is appealing, the test is of little value in the context of historic preservation because preservation measures do not involve a physical invasion.

A second theory, focusing on the extent of the private property owner's loss, was first posited by Justice Holmes in *Pennsylvania Coal Co. v. Mahon*.[112] In *Mahon*, a statute prohibited the mining of coal where such mining would lead to the subsidence of dwelling houses on the surface.[113] The coal company argued that the operation of the statute effected a taking of property rights and impaired its contractual obligations.[114] According to Justice Holmes, the determination of a taking depends upon the extent of the diminution of property value: "When [the diminution in value] reaches a certain magnitude in most if not all cases there must be an exercise of eminent domain and compensation to sustain the act."[115] Because the market value loss is the primary basis for the landmark owner's claim, the Holmes test, stressing the diminution of property value, is especially significant in evaluating alleged takings by states under historic preservation statutes.

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109. Four well-known commentators, Professors Berger, Costonis, Michelman, and Sax, have each written extensively on governmental "taking." Each has posited a different test to determine if a "taking" has occurred and what constitutes just compensation. *See* Berger, *The Accommodation Power in Land Use Controversies: A Reply to Professor Costonis*, 76 COLUM. L. REV. 799 (1976); Berger, *A Policy Analysis of the Taking Problem*, 49 N.Y.U. L. REV. 165 (1974); Costonis, *The Disparity Issue: A Context for the Grand Central Terminal Decision*, 91 HARV. L. REV. 402 (1977); Costonis, *"Fair" Compensation and the Accommodation Power: Antidotes for the Taking Impasse in Land Use Controversies*, 75 COLUM. L. REV. 1021 (1975); Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967); Sax, *Takings, Private Property and Public Rights*, 81 YALE L.J. 149 (1971); Sax, *Takings and the Police Power*, 74 YALE L.J. 36 (1964). For a concise discussion of each professor's theory, see Gerstell, *Needed: A Landmark Decision — Takings, Landmark Preservation, and Social Cost*, 8 URB. LAW. 213, 228-36 (1976).

110. *See, e.g.*, Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982) (physical occupation of a plaintiff's property that occurred in connection with a television company's installation of cables on plaintiff's apartment building constituted a taking where installation was pursuant to New York law requiring landlord to permit such an installation); United States v. Causby, 328 U.S. 256 (1946) (direct overflights above claimant's land); Pumpelly v. Green Bay Co., 80 U.S. (13 Wall.) 166 (1871) (government flooded plaintiff's land).

111. For an excellent discussion on the history of the "taking clause" and the framers' intent, see Sax, *Takings and the Police Power*, 74 YALE L.J. 36, 54-60 (1964).

112. 260 U.S. 393 (1922).

113. *Id.* at 395; *see id.* at 393-94 n.1 (summary of the entire statute at issue).

114. *Id.* at 395.

115. *Id.* at 413.

A third test examines the reason for the government's use of the police power.[116] Where the police power is used to remove a nuisance or to regulate the property of one who is causing a public harm, no compensation is due, regardless of the extent of the private loss.[117] On the other hand, where a regulation forces an individual to produce a public benefit, compensation is required.[118] Using this type of harm/benefit analysis, the restrictions imposed by historic preservation statutes or ordinances force a landmark owner to confer a public benefit and thus require compensation.

A fourth approach, similar to the harm/benefit analysis, employs a balancing test in which the public gains are weighed against the private loss. Where the public gains outweigh the private loss, compensation is required.[119] This weighing test endeavors to alleviate the public burdens of the regulation in an equitable manner:

> The Fifth Amendment's guarantee that private property not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.[120]

Of the four tests, the *Penn Central* Court's "taking" analysis bears the strongest resemblance to the approach employed by Justice Holmes in *Mahon*.[121] The *Penn Central* Court's use of this test demonstrates the high Court's reluctance to draw a "bright line" in the "taking" area, opting instead for a "facts and circumstances" approach.[122] As in *Mahon*, the Court in *Penn Central* focused upon the extent of the prop-

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116. *See* United States v. Central Eureka Mining Co., 357 U.S. 155, 181-84 (1957) (Harlan, J., dissenting); United States v. Caltex, Inc., 344 U.S. 149, 156 (1952) (Douglas, J., dissenting); *see also* Dunham, Griggs v. Allegheny County *in Perspective: Thirty Years of Supreme Court Expropriation Law*, 1962 SUP. CT. REV. 63, 80-81.

117. *See* Miller v. Schoene, 276 U.S. 272, 277 (1928); Hadacheck v. Sebastian, 239 U.S. 394, 410-11 (1915).

118. *See, e.g.*, Nashville, Chattanooga & St. Louis Ry. v. Walters, 294 U.S. 405 (1935) (railroad required to pay portion of expenses for public highway underpasses); Morris County Land Improvement Co. v. Township of Parsippany-Troy Hills, 40 N.J. 539, 193 A.2d 232 (1963) (plaintiff's land to be used as a floodwater basin). *But see* United States v. Central Eureka Mining Co., 357 U.S. 155 (1958) (during Korean War miners prohibited from mining gold because they were needed to mine copper); United States v. Caltex, Inc., 344 U.S. 149 (1952) (plaintiff's oil facilities destroyed by U.S. military during World War II pursuant to "scorched earth" policy). For a detailed explanation of this theory, see Dunham, *supra* note 116, at 77-81.

119. Dunham, *supra* note 116, at 76; Dunham, *A Legal and Economic Basis for City Planning*, 58 COLUM. L. REV. 650, 666 (1958).

120. Armstrong v. United States, 364 U.S. 40, 49 (1960), *quoted in* Penn Central Transp. Co. v. New York City, 438 U.S. 104, 123 (1978).

121. *Compare* Penn Central Transp. Co. v. New York City, 438 U.S. 104, 136-38 (1978) (loss of pre-existing use) *with* Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 413-15 (1922) (diminution of market value).

122. *Penn Central*, 438 U.S. at 124.

erty owner's loss in value in determining whether a "taking" had occurred.[123] In contrast to *Mahon*, however, the *Penn Central* Court analyzed whether the property owner suffered a loss of any pre-existing use.[124] Finding that no such loss occurred on the facts at bar,[125] the *Penn Central* Court held that the Terminal's designation as a landmark did not effect a "taking" in violation of the fifth and fourteenth amendments.[126]

In determining whether the preservation ordinance imposed too great a burden on the owners of the railroad terminal, the Court focused on two interrelated issues: (1) Penn Central's present ability to use the terminal for its intended purposes, and (2) Penn Central's ability to obtain a reasonable return on its investment.[127] The Court noted that the owners of the property were able to use the property exactly as it had been used since the day it was built.[128] As for "reasonable return," the Court did not attempt to define the term because the owners had stipulated that the property was capable of producing a reasonable return.[129] The Court, however, noted that "[t]he city conceded at oral argument that if appellants can demonstrate at some point in the future that circumstances have so changed that the Terminal ceases to be 'economically viable,' appellants may obtain relief."[130]

Because the *Penn Central* Court repeatedly emphasized the narrowness of its holding,[131] the significance of the opinion lies not in its "taking" analysis, but rather in its recognition of historic preservation laws as a valid exercise of the police power. Faced with a challenge to the constitutionality of landmark legislation, the *Penn Central* Court upheld the validity of restrictions on individual landmarks pursuant to a historic preservation scheme. Thus, the Supreme Court approved historic preservation legislation in general. Although a restriction may constitute an unconstitutional "taking" under certain circumstances, landmark legislation is not per se unconstitutional.

B. Historic Preservation Under Maryland Law

1. Historic Area Zoning

Maryland has empowered all counties and municipalities to enact historic area zoning ordinances,[132] to create historic districts,[133] and to

123. *Id.* at 136.
124. *Id.*
125. *Id.*
126. *Id.* at 138.
127. *Id.* at 136-38.
128. *Id.* at 136.
129. *Id.* at 129.
130. *Id.* at 138 n.6.
131. *Id.* at 124, 129, 138 & n.36.
132. MD. ANN. CODE art. 66B, § 8.01(a)(2) (1983).
133. *Id.* § 8.02.

engage in other historic preservation activity.[134] Section 8.03(a) of Maryland's Zoning and Planning Article allows a county or a municipality to delegate the regulation of a historic district to a "historic district commission" within the community.[135] If such a commission is created, then the statute requires that the commission be composed of residents of the community qualified in such fields as history, architecture, preservation or urban design.[136]

The enabling statute provides that the purpose of any county or municipal ordinance or resolution affecting historic areas shall be:

> (1) to safeguard the heritage of the county or municipal corporation by preserving the district therein which reflects elements of its cultural, social, economic, political, or architectural history;
> (2) to stabilize and improve property values in such a district;
> (3) to foster civic beauty;
> (4) to strengthen the local economy; and
> (5) to promote the use and preservation of historic districts for the education, welfare, and pleasure of the residents of the county or municipal corporation.[137]

Local governments in Maryland are authorized to do more than merely prevent the demolition of buildings within a historic area. Section 8.01(a)(2) specifically empowers local governments to "regulate the construction, alteration, reconstruction, moving and demolition of [historic] structures, their appurtenances and environmental settings within their respective limits."[138] Pursuant to these regulatory powers, section 8.05 provides historic district commissions with the authority to review and to accept or reject any proposed change to property within a historic area.[139]

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134. *Id.* § 8.01(a)(2).

135. *Id.* § 8.03(a). Twenty-nine communities in Maryland have active historic district commissions. Telephone Interview with Mark Edwards, Deputy State Historic Preservation Officer for the Maryland Historical Trust (Feb. 8, 1985) [hereinafter cited as Edwards Interview] (notes on file at University of Baltimore Law Review).

136. MD. ANN. CODE art. 66B, § 8.03(a) (1983). A chief function of a "historic district commission is to review applications to build, alter or demolish a structure within a historic district." *Id.* § 8.05. The commission, however, is only empowered to consider the effects on the exterior of the building. *Id.* § 8.07; *see* Mayor of Annapolis v. Anne Arundel County, 271 Md. 265, 291, 316 A.2d 807, 821 (1974). Aside from its review powers, the commission is also authorized to accept and hold conservation easements. MD. ANN. CODE art. 66B, § 8.03(a) (1983). The donation of an easement by the owner of a "Certified Historic Structure" to the commission should qualify as a charitable contribution under I.R.C. § 170. *See supra* notes 91-98 and accompanying text. For a survey of states with statutes allowing a governmental instrumentality to hold conservation easements, see Netherton, *Restrictive Agreements for Historic Preservation*, 12 URB. LAW. 54, 62-65 (1980).

137. MD. ANN. CODE art. 66B, § 8.01(b) (1983).

138. *Id.* § 8.01(a)(2).

139. *Id.* § 8.05.

In *Faulkner v. Town of Chestertown*,[140] the Court of Appeals of Maryland interpreted section 8.05 as all-inclusive, so that "if one proposes to do anything to a building within a historic district which will involve changes to the exterior appearance of the structure visible from a street or alley in the district, then one must obtain a permit."[141] This restriction applies to public bodies, as well as private citizens.[142]

2. The Maryland Historical Trust

The cornerstone of Maryland's historic preservation efforts is the Maryland Historical Trust (Trust).[143] Founded in 1961,[144] the Trust performs three major functions: (1) identifying Maryland's historic resources; (2) providing assistance to property owners through financial aid programs; and (3) administering the Internal Revenue Code's twenty-five percent investment tax credit for rehabilitation expenditures.[145]

For land development and planning purposes, historic resources within the state must be identified. Accordingly, the Trust maintains two lists of historic sites: the Maryland landmark list and the Maryland inventory of historic sites.[146] The Maryland landmark list is comprised of: "(1) properties designated as national historic landmarks by the United States Department of Interior, (2) properties listed in the National Register of Historic Places by the United States Department of Interior, and (3) all properties or districts identified by State, county, municipal or other governmental units under historic preservation zoning laws, ordinances, resolutions or regulations."[147] The Maryland inventory of historic sites consists of sites identified by the Trust as having "historic, architectural, archaeological, or cultural merit."[148]

If necessary to preserve a site's historic value, the Trust is authorized to acquire and hold interests in real property.[149] For example, many private property owners have donated conservation easements on historic

140. 290 Md. 214, 428 A.2d 879 (1981).

141. *Id.* at 228, 428 A.2d at 885.

142. Mayor of Annapolis v. Anne Arundel County, 271 Md. 265, 291-92, 316 A.2d 807, 821 (1974) (city's historical district ordinance upheld to prevent demolition of a 100 year old church owned by the county). As a penalty for violating this type of restriction, fines may be imposed by the county or municipality. *See* BALTIMORE, MD., CODE art. 1, § 40(w) (1983).

143. MD. ANN. CODE art. 41, § 181A (1982). The Trust is an instrumentality of the Department of Economic and Community Development. *Id.*

144. 1961 MD. LAWS 1001, 1002 (codified at MD. ANN. CODE art. 41, § 181A (1982)).

145. Edwards Interview, *supra* note 135. For a statutory list of the powers and duties of the trustees of the Maryland Historical Trust, see MD. ANN. CODE art. 41, § 181E (1982 & Supp. 1984).

146. MD. ANN. CODE art. 41, § 181KA (1982).

147. *Id.* § 181KA(b).

148. *Id.* § 181KA(a).

149. *Id.* § 181E(c). The Trust is authorized to acquire such property through gift, purchase, devise or bequest. *Id.*

structures to the Trust for protection of the property's unique features.[150] These conservation easements provide an economical means of safeguarding the historic value of the property, without imposing the high costs of acquisition and maintenance upon the Trust.

To promote historic preservation in Maryland, the Trust is empowered to act as a depository for funds and grants from the state and the federal government.[151] These funds, in the forms of loans[152] and grants,[153] are available to individuals and businesses for preservation projects.

Under the guidance of the Trust, the twenty-five percent investment tax credit available under the Internal Revenue Code for a CHS[154] has produced phenomenal results in Maryland. In 1984, Maryland ranked third among all states in the number of rehabilitation projects undertaken.[155] The Trust has been instrumental in Maryland's success by assisting owners, developers, architects, and builders in complying with the requirements of the investment tax credit program. Specifically, the Trust has worked closely with property owners in completing two of the steps necessary to qualify for the twenty-five percent credit.[156] First, the Trust makes the initial determination as to the particular structure's historical significance.[157] Second, the Trust reviews the property owner's rehabilitation plan to ensure consistency with the historic character of

150. As of February, 1985, the Trust held approximately 225 conservation easements, covering over 6,000 acres of property. Edwards Interview, *supra* note 135.

151. MD. ANN. CODE art. 41, § 181E(b) (1982).

152. *Id.* § 181-I-1. Section 181-I-1 creates a Capital Revolving Fund for Historic Preservation. *Id.* § 181-I-1(a). Before a loan can be made under this statute the property must be listed on either the National Register or the Maryland inventory of historic sites. *Id.* Also, loans may be made only after the Board of Public Works has determined that private financing is not available. *Id.* § 181-I-1(b) (Supp. 1984).

153. *Id.* § 181-I-2. Section 181-I-2 creates a Capital Grant Fund for Historic Preservation. *Id.* § 181-I-2(a). Grants can be made to non-profit organizations, political subdivisions, or individuals "for the purpose of acquiring, preserving, restoring, or rehabilitating properties or structures that the Maryland Historical Trust determines are of historical, architectural, or cultural significance." *Id.* § 181-I-2(a)(3). One condition of the grant is that the recipient of the grant convey a conservation easement to the Trust. *Id.* § 181-I-2(a)(3).

154. *See supra* note 47 and accompanying text.

155. Edwards Interview, *supra* note 135. Maryland trailed only New York and California in the number of rehabilitation projects undertaken in 1984. The Trust certified 215 projects, resulting in the expenditure of over $115 million in private funds at an average cost of $534,000 per project. *Id.*

156. *See* 1983 MD. HIST. TR. ANN. REP. 8. The Trust "assists the public in project planning, makes site investigations, and reviews and approves rehabilitation plans for conformance with federal requirements." *Id.*

157. To be eligible for the 25 percent tax credit, a structure must be either listed on the National Register or located within an historic district and certified by the Department of Interior as being of historical significance to the district. I.R.C. § 46(b)(4)(A) (1982). Listing in the National Register generally requires a nomination by the state historic preservation officer and approval by the National Park Service. 36 C.F.R. § 60.1(a)(3) (1984). The nomination form submitted by the state historic preservation officer contains a statement and a description of the property's historic significance. *Id.* § 60.3(i).

the structure or the historic district in which the structure is located.[158]

In sum, the efforts of the Trust have aided in the rehabilitation of numerous historic structures in the state, and have placed Maryland among the nation's leaders in the preservation of historic structures.

C. *Tax Incentives for Historic Preservation Under Maryland Law*

Like the federal government,[159] Maryland encourages historic preservation by incorporating tax incentives into various facets of its tax structure. In contrast to the tax *credit* available under section 46 of the Internal Revenue Code, Maryland's taxing scheme provides a tax *deduction* for rehabilitation expenditures incurred in the preservation of historic property.[160] Moreover, Maryland allows a deduction for expenditures on nondepreciable property only,[161] whereas for federal income tax purposes the Section 46 investment tax credit applies only to depreciable property.[162] By restricting the deduction to nondepreciable property, the state avoids giving the taxpayer a double tax benefit on the same expenditures. Thus, the state provides a tax incentive not available under federal law - a deduction for rehabilitation expenditures on nondepreciable property.[163]

Maryland law further allows for real property tax relief for historic property.[164] Section 12G of the Revenue and Taxes Article authorizes counties and municipalities in Maryland to enact ordinances allowing credits against local real property taxes.[165] Section 12G(b) permits a credit of up to ten percent of an owner's expenditures for restoration and preservation of historic property[166] or up to five percent of the cost of constructing a new building in a historic district, as long as the building is architecturally compatible with its historic surroundings.[167] Only two municipalities in Maryland, however, have acted pursuant to this statutory authorization.[168]

D. *Protection of Historic Resources in Baltimore City*[169]

In 1964, Baltimore City began an effort to preserve its historic re-

158. *See* 36 C.F.R. § 67.1 (1984).
159. *See supra* notes 39-98 and accompanying text.
160. MD. ANN. CODE art. 81, § 281A (1980 & Supp. 1984). For the State Comptroller's regulations on the rehabilitation deduction, see MD. ADMIN. CODE tit. 03, § .04.01.07 (1977).
161. MD. ANN. CODE art. 81, § 281A(c) (1980 & Supp. 1984).
162. *See supra* note 65.
163. MD. ANN. CODE art. 81, § 281A(e) (Supp. 1984).
164. *Id.* § 12G.
165. *Id.* § 12G(b).
166. *Id.*
167. *Id.*
168. Prince George's County and the town of Laurel have enacted ordinances allowing the real property tax credit. *See* PRINCE GEORGE'S COUNTY, MD., CODE § 10-235.1 (1982); LAUREL, MD. CODE ch. 16, § 16-2 (1984).
169. Because the vast majority of the preservation activity in Maryland is concentrated in

sources through the creation of the Commission for Historical and Architectural Preservation (CHAP).[170] The purposes of CHAP are fourfold: (1) the designation of historic districts;[171] (2) the compilation and maintenance of a Landmark List and a Special List;[172] (3) the review of applications for construction, alteration, or demolition of structures within historic districts or structures on the Landmark List or the Special List;[173] and (4) the acceptance and expenditure of grants or loans from federal, state, or private sources to further the goals of historic preservation in Baltimore City.[174]

Before the alteration of any exterior architectural feature of a landmark structure or any structure within a historic district, permission must be obtained from CHAP.[175] A complete set of plans and specifications for any proposed alteration must be submitted along with the application for permission.[176]

If the application for alteration is not approved, then a hearing on the application is conducted by CHAP.[177] After the hearing, the application for alteration may be approved if CHAP finds either: (1) that the proposed alteration is "appropriate to the preservation of the particular" district or landmark,[178] or (2) that the alteration, although inappropriate, is "without substantial detriment to the public welfare and without substantial derogation from the intents and purposes of this ordinance, and denial of the application will result in substantial hardship to the applicant."[179] If the application is not approved after the hearing, notice of denial is transmitted to the applicant, complete with a copy of the reasons for the denial.[180] In the event that CHAP finds that the proposed

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the downtown Baltimore area, this section will focus upon Baltimore City in discussing local protection of historic resources.

170. BALTIMORE, MD., CODE art. 1, § 40 (1983).

171. *Id.* § 40(j). CHAP acts upon the recommendation of the Planning Commission of the Mayor and City Council of Baltimore. *Id.*

172. *Id.* § 40(k)-(n). The Landmark List consists of "structures which the Commission deems of such *special* historical or architectural significance, whether or not such structures are within any Historical or Architectural Preservation District. . . ." *Id.* § 40(k) (emphasis supplied). The Special List is comprised of structures "which the Commission deems of such historical or architectural significance, whether or not such structures are within any Historical or Architectural Preservation District. . . ." *Id.* § 40(m). The difference between property recorded on the Landmark List and the property recorded on the Special List lies in the extent to which the historic features of the property are protected. *Id.* § 40(q)(8)-(9).

173. *Id.* § 40(q).

174. *Id.* § 40(s).

175. *Id.* § 40(q)(1).

176. *Id.* § 40(q)(2).

177. *Id.* § 40(q)(4).

178. *Id.* § 40(q)(5)(i). Upon a finding by CHAP that the proposed alteration is consistent with the preservation of the district or landmark a Certificate of Appropriateness may be issued to the applicant. *Id.*

179. *Id.* § 40(q)(5)(ii). In lieu of a Certificate of Appropriateness, CHAP may issue a Notice to Proceed. *Id.*

180. *Id.* § 40(q)(7).

alteration is inappropriate, then the issuance of the permit is postponed, pending consultation among CHAP, the applicant, and other interested parties to arrive at a compromise capable of preserving the building.[181] This administrative procedure is subject to review by the Circuit Court for Baltimore City.[182]

Of all the municipalities in Maryland, Baltimore City has benefited most from the tax incentives favoring historic preservation. Since 1978, individuals and businesses in Baltimore have spent over $350 million on rehabilitation projects, accounting for seventy percent of the total amount expended within the state.[183] Without the tax credit, many of these projects may not have been undertaken.

IV. CONCLUSION

Notwithstanding NHPA's contribution to the goal of identifying structures of historical significance, state and local regulation of historic structures provides the most effective means of protecting the historic features of these structures. State and local historic preservation laws, however, impose a burden on the owners of historic structures because these laws restrict the right of the owner to alter his property's historic features.

Tax incentives offer an opportunity to offset much of this burden by making the historic designation of the property valuable to the property owner. Therefore these tax incentives, because of their importance to the country's historic preservation efforts, should be retained in the event of tax reform legislation.

By empowering all counties and municipalities to enact historic area zoning ordinances, Maryland has authorized local governments to participate in the protection of the state's historic resources. Maryland has also followed Congress's lead by fostering preservation through its tax structure. The preservation efforts in Baltimore City are an excellent example of the success that can be achieved by a combination of state and local regulation with federal and state tax incentives.

Through the use of historic area zoning and tax incentives that promote historic preservation, the ultimate goal of historic preservation may yet be accomplished: to improve the quality of life for future generations by preserving society's links to the past.

Louis P. Ruzzi

181. *Id.* § 40(q)(9)(i)-(ii).
182. *Id.* § 40(v).
183. Edwards Interview, *supra* note 135.