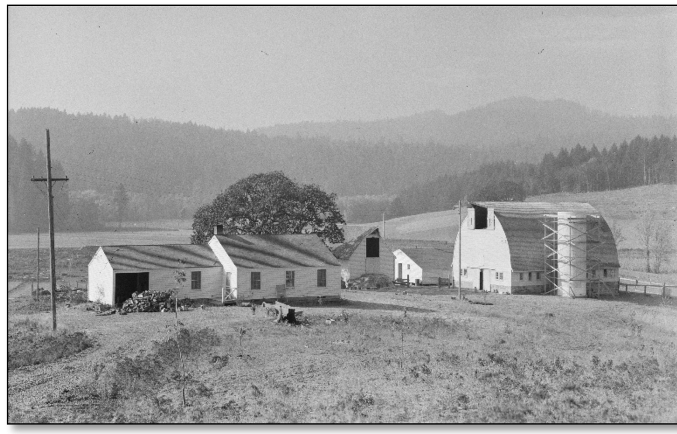
Barn Rehabilitation with Low Adjusted Basis

SMALL PROJECT SCENARIO #1

This scenario is based on a real project, but details have been changed or omitted to protect the privacy of the owners.

Overview



A long-time Oregon family has owned a working farm in a rural community for generations. At the center of the property is a historic timber-frame barn, listed in the National Register of Historic Places, that has been in continuous use for over 100 years. The family decided to make improvements to the barn and to explore using the federal 20% Historic Tax Credit (HTC).

To qualify for the HTC, a project must meet the Substantial Rehabilitation Test, which generally requires that the amount spent on qualifying rehabilitation work exceeds the building's adjusted basis. In simple terms, the adjusted basis is generally calculated as the purchase price of the building excluding the land value, plus capital improvements, and reduced by depreciation taken over time. (The actual calculation can be more complicated; please refer to the calculator provided with this toolkit and consult with a tax advisor on your own adjusted basis calculation.)

For many property owners—especially those who have purchased their buildings more recently—this results in a relatively high adjusted basis, meaning they must invest a significant amount in rehabilitation work to qualify for the credit. In the case of this barn, the building's adjusted basis had been reduced to a very low level because of its long ownership history and depreciation over time. This created an opportunity: because the adjusted basis was so low, the owners only needed to meet the $5,000 statutory minimum threshold for the Substantial Rehabilitation Test. As a result, they were able to qualify for the HTC with a relatively modest rehabilitation project.

Rehabilitation Work Completed

The family completed approximately $52,000 in rehabilitation work, including:

- Repairing and reinforcing deteriorated timber framing
- Replacing failing roofing with in-kind materials
- Stabilizing sections of the foundation
- Repairing original wood siding and repainting
- Upgrading the electrical service to support ongoing farm use

The project met the Secretary of the Interior's Standards for Rehabilitation and all of the work was treated as Qualified Rehabilitation Expenditures (QREs), resulting in $10,400 in HTCs.

Using the Historic Tax Credit

In order to qualify for the credit, a property must have an income-producing use when the project is complete. In this case, the farm is an active business operation and the barn is directly tied to that activity. The owners worked with their CPA to ensure that the farm and related activities were appropriately structured and reported for federal tax purposes. Because the ability to use HTCs depends on the owner's particular tax circumstances, this planning was important. Based on the owners' participation in the farm business and their tax circumstances, the credits could be applied against income generated by the farm.

Key Takeaways

- The historic barn was preserved and continues to support the farm's ongoing operations.
- The building's very low adjusted basis made it possible to satisfy the Substantial Rehabilitation Test with a modest scope of work.
- The owners' particular business and tax circumstances allowed them to make full use of the historic tax credits.

Remember: Every project is different and tax outcomes depend on factors such as ownership structure, adjusted basis, income sources, and tax liability.

Learn More

To learn more about the topics discussed in this scenario, please see the following resources in this toolkit:

- Substantial Rehabilitation Test Calculator
- Module 2: *Understanding Direct Use vs. Syndication of HTCs*
- Module 3: *Understanding Passive Activity Limitations*
- Module 4: *Preparing for a Conversation with Your Tax Advisor*