

Adjusting Cost Basis for Condominium Owners

By Warren Updike

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Introduction: When you sell your Thornton Wood Condo, you may be subject to Federal and State tax on a gain from the sale. Usually, when a home owner sells his or her “Main Home,” all (or part) of any gain on the sale may be excluded from income tax. If it was not your Main Home, it’s possible that the entire gain may be taxable. Condominium owners have a special situation that may apply.

*Note: the IRS Publications referenced in this article may be found at:
<https://www.irs.gov/Forms-&-Pubs>*

The rules are many and complicated, so it is prudent to seek professional advice when you have sold your home or before. IRS Publication 523, “Selling Your Home,” is one useful source.

The Gist of it: In determining the gain on the sale of your home (Main or other home,) there are certain allowed additions to and subtractions from the original cost of your home to arrive at the “adjusted basis.” The “amount realized” less the adjusted basis, determine the gain or loss on the sale. Adjustments that add to your basis are the subject of this article.

Being able to increase the Cost Basis of your home may reduce the gain realized on a dollar-for-dollar basis. Homeowners are allowed to increase the cost basis of their home by certain adjustments. One such adjustment is for improvements to the home, “Add to your basis in property the cost of improvements having a useful life of more than 1 year that increase the value of the property, lengthen its life, or adapt it to a different use.”¹ And, for we at Thornton Wood, the following statement is also important, (add to cost of a home) “Any special assessments for local improvements (such as special tax **or condominium association assessments that are not merely for repairs or maintenance**).”²

So, it’s clear that if you pay to improve your home with things like new doors, windows, air conditioner, &etc., the cost of these may be added to your cost basis. And, for we condominium owners, this includes Special Assessments for what we call certain Capital Improvements.

Why might this be important to you? If you have sold your home during the year³ :

1. If you are married filing a joint return, and are otherwise eligible for the exclusion of gain you may be allowed to exclude up to \$500, 000, of gain on the sale. In this event, it’s not likely you would have a taxable gain from a Thornton Wood Condo unit.
2. If you are single, and are otherwise eligible for the exclusion of gain you may be allowed to exclude up to \$250, 000, of gain on the sale. If you have lived in this home for an extended time, it’s possible to incur a taxable gain.
3. If the home was not your “Main Home,” the entire gain may be taxable to you.

¹ IRS, 2015, Publication 17, pg 99

² IRS, 2015, Publication 523, “Selling Your Home,” pg 8, Ln 4.f.

³ Ditto Pub 523, pg 2.

Any adjustments that increase your cost basis may reduce your gain and, consequently, reduce any tax liability. It is important to note that, for condominium owners, adjustments for improvements to Common Elements⁴ are based on the assessment of, rather than the cost of the improvement, or whether or when the Condominium Association actually incurs the expense for such improvements. In the only on-point statement I could find on the issue, Gary Porter, CPA, RS, PRA⁵, opines, “The only logical conclusion that can be reached at this time is that a unit owner’s basis will include any capital assessments paid by the unit owner(s) to the association whether the association has expended such funds or not.” This is the opinion on which I choose to be guided; and, appears to be supported by the IRS^(see footnote 2).

For improvements you have made to your home, it’s important that you have the records to support adjustments you make to your cost basis. For condominium Special Assessments for qualified improvements, you will also need proper support for the cost basis adjustments.

Thornton Wood History: Prior to about 1987, Thornton Wood Condominium Association did not have a Reserve Fund for improving/replacing capital assets. Starting with Fiscal Year 1988, an amendment to the Thornton Wood Condominium Association By-laws provided for the creation of a “...reserve for replacement of major capital assets...” This reserve and the annual contributions to the reserve have been made every year thereafter.

Beginning with Fiscal Year 2015, the By-laws were further amended to extend the purpose of the Reserve Fund to include, “...costs exceeding 3% of the annual operating budget for major maintenance and/or repair of major capital assets...”⁶ From that point and continuing in the future, not all of the annual reserve assessment may qualify as “improvements.” Included with that amendment to the By-laws is the authorization to use the reserve funds for, “...periodic updates to the Condominium's reserve study.”

A “reserve study,” is “...a physical analysis and a financial analysis... regarding the physical status and repair/replacement cost of the association’s major common area components” to determine a recommended level of reserves and appropriate reserve contribution rate (funding plan.)⁷ The first reserve study for Thornton Wood was conducted, January 2012, and was updated in January 2015. The reserve study delivers a detailed plan of expenditures by component and year, along with a finding plan designed to provide the necessary funds to meet the planned expenditures in the year planned.

It seems that since the start of the reserve fund and up until the 2014 amendment of the By-laws, 100% of the assessments for the Reserve Fund were for qualified planned improvements, and,

⁴ For definition of terms relating to Thornton Wood, including “Common Elements,” see the Thornton Wood Declaration at: http://thorntonwood.org/dec_bylaw.htm

⁵ HOA Pulse Exclusives, “Unit Owners Tax Basis in Condo Associations,” Gary Porter, Feb 18, 2012

<http://www.hoapulse.com/component/k2/item/11093-unit-owners-tax-basis-in-condo-associations>

⁶ Thornton Wood By-laws, Article 6, Section 1., pg B13

⁷ Report #1, “Reserve Studies/Management”, Foundation for Community Association Research

therefore, allowable as additions to owners cost basis for tax purposes. The issue, then, is what part of the reserve assessments for FY2015 and beyond constitute qualified improvements? The IRS does not appear to provide any guidance for this question. Owners seem left to their own devices and opinions of their tax advisors. Your Association has the plan of Reserve Expenditures that may be used to determine what part, if any, of planned expenditures for a given year could be disallowed as maintenance or repair, and, therefore, not allowable as a qualified expense for the purpose of adjusting cost basis. Such plan of Reserve Expenditures may be obtained by owners with a request to the Board of Directors or Property Manager. (See "[Contacts](#)" on our TWCA website)

History of Assessments: There are original records of Thornton Wood Condominium Association budgets and assessments back to FY'2007. Prior to that, data is sketchy and must be reconstructed from what is available and known. The earlier years must be derived from available data based on known relationships that are documented and defensible. The resulting reconstructed data appear consistent with the data for which we have current records. This history is presented in the document "[Budget and Capital Assessment History](#)". The column, "Annual Cost Basis Adj." are the amounts of Reserve Assessments for the years shown.

In the End: Initially, I thought the tax benefit would be more significant that it is likely to be for most owners. However, the very recent Reserve Assessments are rather more significant than those earlier, and should be considered by those selling a Thornton Wood unit in the recent past⁸ or expect to in the future. Any actual tax benefit will depend on the particular circumstances of the owner(s).

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If you are a unit owner of Thornton Wood Condominium Association, you may contact the author to discuss the information or request copies.

About the author: [Warren Updike](#) has a degree in accounting, and is an IRS certified volunteer tax preparer. He is not, however, a tax accountant nor tax lawyer. His opinions contained in this article are entirely his own and do not constitute tax advice on the matters presented herein. Readers are advised to seek and be guided by their own tax advisor.ⁱ

ⁱ Endnote: A printable copy of the "Budget and Capital Assessment History" in the PDF format may be downloaded at [this location](#).

⁸ IRS, 2015, Publication 17, Generally, a taxpayer may amend a Federal Tax Return for a period of three years. See "Time for filing a claim for refund," pg. 17