PacificCPE

COURSE
31053C

Individual Income Tax: Gains and Losses

Understanding property transactions is essential for accurate individual return preparation. This course covers how to determine and adjust the basis of property, the rules governing sales and trades, capital gain and loss treatment, and the home sale exclusion. You'll also learn how to correctly report capital gains and losses, including key considerations for business use of a home. Ideal for practitioners who regularly handle clients with investment or real property dispositions.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify the factors to consider in calculating the basis of property.
- Recognize the taxability of the sale of personal use property.
- Identify the special tax rules related to selling your home.
- Recall the capital gain rates for the current year.

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Chapter 1: BASIS OF PROPERTY

Chapter Objective

After completing this chapter, you should be able to:

- Identify the factors to consider in calculating the basis of property.

I. REMINDERS

Special rules for capital gains invested in Qualified Opportunity Funds. Effective December 22, 2017, Code section 1400Z-2 provided a temporary deferral of inclusion in gross income for certain capital gains invested in Qualified Opportunity Funds (QOFs), and a potential permanent exclusion of gains from the sale or exchange of an investment in a QOF if the investment is held for at least 10 years. For more information, see the Instructions for Form 8949.

Note

The OBBBA made this provision permanent.

II. INTRODUCTION

This chapter discusses how to figure your basis in property. It is divided into the following sections.

- Cost basis.
- Adjusted basis.
- Basis other than cost.

Basis is the amount of your investment in property for tax purposes. Use the basis of property to figure gain or loss on the sale, exchange, or other disposition of property. Also use it to figure deductions for depreciation, amortization, depletion, and casualty losses.

If you use property for both business and personal purposes, you must allocate the basis based on the use. Only the basis allocated to the business use of the property can be depreciated.

Your original basis in property is adjusted (increased or decreased) by certain events. If you make improvements to the property, increase your basis. If you take deductions for depreciation or casualty losses, or claim certain credits, reduce your basis.

III. COST BASIS

The basis of property you buy is usually its cost. The cost is the amount you pay in cash, debt obligations, other property, or services. Your cost also includes amounts you pay for the following items.

- Sales tax.
- Freight.
- Installation and testing.
- Excise taxes.
- Legal and accounting fees (when they must be capitalized).
- Revenue stamps.
- Recording fees.
- Real estate taxes (if assumed for the seller).

In addition, you may also have to capitalize (add to basis) certain other costs related to buying or producing property.

Loans with low or no interest. If you buy property on a time-payment plan that charges little or no interest, the basis of your property is your stated purchase price minus any amount considered to be unstated interest. You generally have unstated interest if your interest rate is less than the applicable federal rate.

REAL PROPERTY

Real property, also called real estate, is land and generally anything built on, growing on, or attached to land.

If you buy real property, certain fees and other expenses you pay are part of your cost basis in the property.

Lump sum purchase. If you buy buildings and the land on which they stand for a lump sum, allocate the basis among the land and the buildings so you can figure the allowable depreciation on the buildings. Land is not depreciable. Allocate the cost according to the fair market values of the land and buildings at the time of purchase. Figure the basis of each asset by multiplying the lump sum by a fraction. The

numerator is the FMV of that asset and the denominator is the FMV of the whole property at the time of purchase.

Fair market value (FMV) is the price at which the property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both have reasonable knowledge of all the necessary facts. Sales of similar property on or about the same date may be helpful in figuring the FMV of the property.

Assumption of mortgage. If you buy property and assume (or buy the property subject to) an existing mortgage on the property, your basis includes the amount you pay for the property plus the amount to be paid on the mortgage.

Settlement costs. You can include in the basis of property you buy the settlement fees and closing costs for buying the property. (A fee for buying property is a cost that must be paid even if you buy the property for cash.) You cannot include fees and costs for getting a loan on the property in your basis.

The following are some of the settlement fees or closing costs you can include in the basis of your property.

- Abstract fees (abstract of title fees).
- Charges for installing utility services.
- Legal fees (including title search and preparation of the sales contract and deed).
- Recording fees.
- Survey fees.
- Transfer taxes.
- Owner’s title insurance.
- Any amounts the seller owes that you agree to pay, such as back taxes or interest, recording or mortgage fees, charges for improvements or repairs, and sales commissions.

Settlement costs do not include amounts placed in escrow for the future payment of items such as taxes and insurance.

The following are some of the settlement fees and closing costs you cannot include in the basis of property.

1. Casualty insurance premiums.
2. Rent for occupancy of the property before closing.

3. Charges for utilities or other services related to occupancy of the property before closing.
4. Charges connected with getting a loan. The following are examples of these charges. a)Points (discount points, loan origination fees). b)Mortgage insurance premiums. c)Loan assumption fees. d)Cost of a credit report. e)Fees for an appraisal required by a lender.
5. Fees for refinancing a mortgage.

Real estate taxes. If you pay real estate taxes the seller owed on real property you bought, and the seller did not reimburse you, treat those taxes as part of your basis. You cannot deduct them as an expense.

If you reimburse the seller for taxes the seller paid for you, you can usually deduct that amount as an expense in the year of purchase. Do not include that amount in the basis of your property. If you did not reimburse the seller, you must reduce your basis by the amount of those taxes.

Points. If you pay points to get a loan (including a mortgage, second mortgage, line of credit, or a home equity loan), do not add the points to the basis of the related property. Generally, you deduct the points over the term of the loan. For more information, see Points in Chapter 4 of course 31056N.

Points on home mortgage. Special rules may apply to points you and the seller pay when you get a mortgage to buy your main home. If certain requirements are met, you can deduct the points in full for the year in which they are paid. Reduce the basis of your home by any seller-paid points.

IV. ADJUSTED BASIS

Before figuring gain or loss on a sale, exchange, or other disposition of property or figuring allowable depreciation, depletion, or amortization, you must usually make certain adjustments (increases and decreases) to the cost of the property. The result is the adjusted basis.

INCREASES TO BASIS

Increase the basis of any property by all items properly added to a capital account. Examples of items that increase basis are shown in Table 13-1.

TABLE 13-1. EXAMPLES OF ADJUSTMENTS TO BASIS

Increases to Basis	Decreases to Basis
• Capital improvements: Putting an addition on your home Replacing an entire roof Paving your driveway Installing central air conditioning Rewiring your home • Assessments for local improvements: Water connections Sidewalks Roads • Casualty losses: Restoring damaged property • Legal fees: Cost of defending and perfecting a title • Zoning costs	• Exclusion from income of subsidies for energy conservation measures • Casualty or theft loss deductions and insurance reimbursements • Certain vehicle credits • Section 179 deduction • Depreciation • Nontaxable corporate distributions

Improvements. Add to your basis in property the cost of improvements having a *useful life* of more than one year, that increase the value of the property, lengthen its life, or adapt it to a different use. For example, improvements include putting a recreation room in your unfinished basement, adding another bathroom or bedroom, putting up a fence, putting in new plumbing or wiring, installing a new roof, or paving your driveway.

Assessments for local improvements. Increase the basis of property by assessments for items such as paving roads and building ditches that increase the value of the property assessed. Do not deduct them as taxes. However, you can deduct as taxes charges for maintenance, repairs, or interest charges related to the improvements.

Example

Your city changes the street in front of your store into an enclosed pedestrian mall and assesses you and other affected property owners for the cost of the conversion. Add the assessment to your property’s basis. In this example, the assessment is a depreciable asset.

DECREASES TO BASIS