

Investment Calculations

1. Annual Deductions: Home owners are allowed annual tax deductions for mortgage interest and real property taxes and may be deducted in the year paid.

Example: As a homeowner during 1986, you paid \$7,000 in mortgage interest and \$900 in real property taxes. You reduced the principal loan by \$4,500, paid \$350 in maintenance costs and annual insurance premium was \$360. What are your total annual deductions?

Solution: \$7,000 Interest + \$900 Taxes = \$7,900

Note: "Discount points" paid by a buyer may also be deductible during year paid. "Discount points" on a VA loan paid by a seller are considered to be a "service charge" and not deductible by a seller.

2. Basis and Adjusted Basis

- A. The "cost" (sales price) is referred to as "Basis".
- B. Adjusted basis: closing costs may be added to sales price.

Example: You bought a home for \$72,000 sales price and paid \$1,500 in closing costs. Your adjusted basis is \$73,500.

- C. You may add costs of capital improvements during ownership to determine the "adjusted basis". Remember normal wear and tear and maintenance is not capital improvements.

Example: You bought the home for \$72,000 and paid \$1,500 in closing costs. Over the next 5 years you added a deck for \$2,000 and a carport for \$4,000. You painted the house for \$1,700. What is the adjusted basis?

Solution: \$72,000 Purchase Price + \$1,500 Closing Costs + \$2,000 Deck + \$4,000 Carport = \$79,500 Adjusted Basis

Note: The \$1,700 for painting is maintenance, not a capital improvement.

3. Determining Amount Realized

A. The amount realized is the sales price when you sell it, less the seller's closing costs.

Example: You sell the above home for \$110,000. You paid a 6% commission and other seller closing costs was \$800. What is the amount realized?

Solution:

\$110,000 Sales Price - \$6,600 Commission - \$800 in closing costs = \$102,600 Amount realized.

4. Determining the Gain

The gain is the difference between adjusted basis and amount realized.

Example: John bought a home in July, 1984 for \$85,000, paying \$20,000 down and obtaining a mortgage of \$65,000. Closing costs were \$900. In 1985, John built a workshop on the property at a cost of \$12,000. He sold the house in February of 1987 for \$115,000 (involving \$25,000 cash down, assumption of the mortgage which had a balance of \$60,000 and a second mortgage to Able for \$30,000). John paid a real estate commission and closing costs totaling \$7,000. His gain or loss realized is calculated as follows:

Solution:

Step 1: Determine the amount realized:

Sale Price	\$115,000
Less: Selling Expenses	<u>-\$7,000</u>
Amount Realized	\$108,000

Step 2: Determine the adjusted basis:

Cost (Basis)	\$85,000
Add: Closing Costs	+\$900
Add: Capital Improvements	<u>+\$12,000</u>
Adjusted Basis	\$97,900

Step 3: Determine the Gain:

Amount Realized	\$108,000
Less: Adjusted Basis	<u>-\$97,900</u>
Gain Realized	\$10,100

Example: Sam bought a personal residence in 1982 for \$65,000 and paid \$1,500 in closing costs. During ownership, he added \$4,000 worth of capital improvements. In 1988, Sam sold

the house for \$95,000, paying a 6½% commission and other closing expenses of \$1,550. What is the capital gain?

- (a) \$27,775 (b) \$30,000 (c) \$18,775 (d) \$16,775

Solution:

$\$95,000 - \$6,175 \text{ Comm.} - \$1,550 = \$87,275$ Amount Realized

$\$65,000 + 1,500 \text{ Closing} + \$4,000 \text{ Cap. Improvements} = \$70,500$ Adjusted Basis

$\$87,275 - \$70,500 = \$16,775$ Capital Gain (d)