Math Relating To Sale of a Personal Residence and Federal Taxation

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 $l,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	-$7,000
Amount Realized	$108,000

Step 2: Determine the adjusted basis:

Cost (Basis)	$85,000
Add: Closing Costs	+$900
Add: Capital Improvements	+$12,000
Adjusted Basis	$97,900

Step 3: Determine the Gain:

Amount Realized	$108,000	
Less: Adjusted Basis		-$97,900
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) $l8,775 (d) $16,775

Solution:

$95,000 - $6,175 Comm. - $1,550 = $87,275 Amount Realized
$65,000 +1,500 Closing + $4,000 Cap. Improvements = $70,500 Adjusted Basis
$87,275 - $70,500 = $16,775 Capital Gain (d)