

Chapter 15 – Federal Income Taxation and Real Estate

1. D

Explanation: Mortgage interest, a mortgage prepayment penalty, and property taxes are all deductible expenses for a personal residence. Note that only payments of mortgage interest, not mortgage principal, are deductible.

2. B

Explanation: Recognized gain is the gain that is taxed in the year of the transaction from which it is realized.

3. B

Explanation: As property used in a trade or business, a commercial apple orchard could be depreciated for income tax purposes.

4. C

Explanation: Depreciation has the effect of lowering the property's cost basis.

5. C

Explanation: Erin's capital gain is the sales price minus her adjusted cost basis. Adjusted cost basis is initial cost basis minus depreciation. So the sales price (\$250,000) minus the adjusted cost basis (\$200,000) is \$50,000.

6. B

Explanation: In a tax-free exchange, both the old and new properties must be held for income or investment or used in a trade or business. Here, both Jerry's former and new properties are rental properties. Tom, however, previously owned a personal residence and thus does not qualify for a tax-free exchange.

7. C

Explanation: The apartment complex's equity is \$88,000 and the duplex's equity is \$118,200. The difference is \$30,200 and is the amount that the apartment complex owner will pay to the duplex owner in boot.

8. B

Explanation: He may deduct his share of the interest paid on a mortgage of the common areas. Individual unit maintenance and repair costs are not deductible and neither are assessments for upkeep of common areas.

9. A

Explanation: As a capital improvement, a new deck would be added in calculating the adjusted cost basis. Note that depreciation is not taken into account when calculating the adjusted basis of a personal residence.

10. D

Explanation: Capital expenditures are added to the cost basis of the property.

11. B

Explanation: Lost income from vacancies is simply not reported as income. The other expenses are tax-deductible.

12. C

Explanation: To be eligible for a tax-free exchange, a property must be used in a trade or business or held for income or investment. It must be exchanged for like-kind property.

13. B

Explanation: In an installment sale, the seller must pay taxes only on the gain received during each tax year. Thus, the gain is prorated over the course of the installment contract.

14. A

Explanation: "Boot" can be cash, property, or other consideration, including mortgage relief.

15. A

Explanation: The properties exchanged must be income-producing or investment properties. Personal residences are not eligible for an exchange. Boot is necessary only when the real properties are of unequal value. The exchange must be completed within 180 days after closing.