# Advanced Individual Income Tax

## Documents for Lecture on Chapter 14

# Tax Consequences of Home Ownership

UNC Charlotte MACC Program

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# Trailer town misses million-dollar payday-20070808

**Developer makes offer for 488-unit Briny Breezes in Fla.**

AUDRA D.S. BURCH, McClatchy Newspapers

For the past seven months, the residents of a **488-unit trailer-park town** in Palm Beach County were millionaires, at least on paper. They had enough money to finance the future, to commit to new homes, to pick out shiny new boats.

**The deal would have paid each property owner, most of them seasonal, roughly a million dollars, then turned this old wisp of land wedged between the Atlantic Ocean and the Intracoastal Waterway into a high-rise mega-resort.**

Ocean Land officials, who had placed $500,000 of the deposit in escrow, say the deal's collapse is more a matter of timing than money, and they promise to renegotiate, only with a perhaps less generous plan.

"We still needed to have conversations with the neighboring communities of Ocean Ridge and Gulf Stream,'' says Logan Pierson, Ocean Land's vice president of acquisitions. "We needed to hear their concerns and come back with something compatible. We are hopeful that in the long run, after emotions cool, this works out."

Now, angered and chastened by the last-minute jilt, the town is already considering other suitors, although residents are keeping mum about the details.

Whatever happens, the 1,000 Brinyites, as they call themselves, are stuck for now..

"We have people here who have already bought homes and condos in the areas of Orlando, Okeechobee, Boynton Beach and Vero Beach," Bennett says. "Some have put deposits down on time shares and bought boats, too.

"People were really banking on that money. This is really a sad situation."

Bennett, 73, and his wife, Barbara, have lived here full time for 12 years and are still mulling their options. A retired communications professor, Bennett has been busier the past week fielding inquiries from the media -- Geraldo, CNN, ABC, all interested in reporting the millionaires-today, money-gone-tomorrow story. As Bennett talks about the town's sudden celebrity, he walks past a sign: "There's no place like Briny."

Since negotiations are continuing, and other developers are discussing the purchase of this prime property, we assume the residents will still get their dream payday.

1. Assume your client is Maude, who is single. Four years ago, she paid $40,000 for her mobile home and $20,000 for the lot. A company is willing to pay Maude $1,060,000 for her property.

   What is her recognized gain on the sale? Assume she will not incur selling expenses.
2. She has been dating Bob, who lives in Birmingham. She told him about this deal, and he suggested that he sell his home in Birmingham and move in with her-- and marry her. How does that affect the tax result?
3. Assume, Bob came to live with Maude 3 years ago, but they waited about getting married until last month. How does that affect the tax result?

## Qui Van Phan v. Commissioner., U.S. Tax Court, T.C. Summary Opinion 2015-1, (Jan. 12, 2015)

Qui Van resided in California when he filed the petition.

In 2008 Qui Van moved into a house on a three-acre ranch in California (property) to help his mother, who was unable to care for the property. He lived at the property during 2010. During this time his mother was in the process of divorcing his father. His father left the property before 2008 and did not live there at all in 2010. As part of the divorce settlement his mother would pay his father in exchange for his father's interest in the property.

In order to secure the needed funds, the mortgage loan for the property was refinanced in 2011.

Because of his financial situation Qui Van was not able to buy the property. **However, Qui Van entered into an oral agreement with his mother and his siblings that he would pay the mortgage loan and the property taxes and these payments would increase his equity interest in the home. Qui Van 's sister and sister-in-law refinanced the mortgage loan for the property in 2011. In 2013 Qui Van 's name was added to the legal title to the property.**

**In 2010 the legal title to the property was held by Qui Van 's mother, brother, and father. His brother and father were not living at the property. Qui Van 's mother was unable to take care of the property on her own.**

During 2010 Chase held a mortgage on the property. The mortgage was not held in Qui Van's name. During 2010 Chase received monthly mortgage payments from Qui Van of $3,958. Qui Van maintained a bank account with Wells Fargo, and his bank statements for 2010 show a monthly check for $3,958 paid to Chase.

**Qui Van filed a Form 1040, U.S. Individual Income Tax Return, for tax year 2010. He attached a Schedule A, Itemized Deductions, to his Form 1040 on which he claimed a $35,880 deduction for home mortgage interest.**

**On April 8, 2013, IRS issued Qui Van a notice of deficiency disallowing Mr. Phan's claimed home mortgage interest deduction and imposing the accuracy-related penalty under section 6662(a).**

1. Section 163(a) allows a deduction for all interest paid or accrued within the taxable year on indebtedness.
2. Section 163(h)(1), however, provides that, in the case of a taxpayer other than a corporation, no deduction is allowed for personal interest.
3. Qualified residence interest is excluded from the definition of personal interest and thus is deductible under section 163(a). See sec. 163(h)(2)(D).
4. **Qualified residence interest** is any interest that is paid or accrued during the taxable year on acquisition indebtedness or home equity indebtedness. See sec. 163(h)(3)(A).
5. For any period, the aggregate amount of home acquisition indebtedness may not exceed $1 million. Sec. 163(h)(3)(B)(ii).
6. **The indebtedness generally must be an obligation of the taxpayer and not an obligation of another**.
   See Golder v. Commissioner, 604 F.2d 34, 35 (9th Cir. 1979), aff'g T.C. Memo. 1976-150.
7. Section 1.163-1(b), Income Tax Regs., however, provides that even if a taxpayer is not directly liable on a bond or note secured by a mortgage, the taxpayer may nevertheless deduct the mortgage interest paid if he or she is the legal or equitable owner of the property subject to the mortgage.
8. State law determines the nature of property rights, such as legal or equitable ownership, while Federal law determines the appropriate tax consequences of those rights.

**What do you Say?**

**Chapter 14. Tax Consequences of Home Ownership**

**38.** Lauren owns a condominium. In each of the following alternative situations, determine whether the condominium should be treated as a residence or nonresidence for tax purposes?

a. Lauren lives in the condo for 19 days and rents it out for 22 days.
b. Lauren lives in the condo for 8 days and rents it out for 9 days
c. Lauren lives in the condo for 80 days and rents it out for 120 days
d. Lauren lives in the condo for 30 days and rents it out for 320 days.

**43.** Sarah (single) purchased a home on January 1, 2008 for $600,000. She eventually sold the home for $800,000. What amount of the $200,000 gain on the sale does Sarah recognize in each of the following alternative situations? (Assume accumulated depreciation on the home was $0.)

e. Sarah used the home as her principal residence through December 31, 2015. She used the home as a vacation home from January 1, 2016 until she sold it on January 1, 2018.
f. Sarah used the property as a vacation home through December 31, 2015. She then used the home as her principal residence from January 1, 2016 until she sold it on January 1, 2018.
g. Sarah used the home as a vacation home from January 1, 2008 until January 1, 2017. She used the home as her principal residence from January 1, 2017 until she sold it on January 1, 2018.
h. Sarah used the home as a vacation home from January 1, 2008 through December 31, 2011. She used the home as her principal residence from January 1, 2012 until she sold it on January 1, 2017.

**48.** Lewis and Laurie are married and jointly own a home valued at $240,000. They recently paid off the mortgage on their home. In need of cash for personal purposes unrelated to the home, the couple borrowed money from the local credit union. How much interest may the couple deduct in each of the following alternative situations (assume they itemize deductions no matter the amount of interest)?

i. The couple borrows $40,000 and the loan is secured by their home. They use the loan proceeds for purposes unrelated to the home. The couple pays $1,600 interest on the loan during the year and the couple files a joint return.
j. The couple borrows $10,000 unsecured from the credit union. The couple pays $900 interest on the loan during the year and the couple files a joint return.
k. The couple borrows $110,000 and the loan is secured by their home. The couple pays $5,200 interest on the loan during the year and the couple files a joint return.
l. The couple borrows $110,000 and the loan is secured by their home. The couple pays $5,200 interest on the loan during the year and the couple files separate tax returns. Determine the interest deductible by Lewis only.

**56.** Jesse Brimhall is single. In 2017, his itemized deductions were $4,000 before considering any real property taxes he paid during the year. Jesse's adjusted gross income was $70,000 (also before considering any property tax deductions). In 2017, he paid real property taxes of $3,000 on property 1 and $1,200 of real property taxes on property 2.

a. If property 1 is Jesse's primary residence and property 2 is his vacation home (he does not rent it out at all), what is his taxable income after taking property taxes into account?
b. If property 1 is Jesse's business building (he owns the property) and property 2 is his primary residence, what is his taxable income after taking property taxes into account?
c. If property 1 is Jesse's primary residence and property 2 is a parcel of land he holds for investment, what is his taxable income after taking property taxes into account?

Natalie owns a condominium near Cocoa Beach in Florida. This year, she incurs the following expenses in connection with her condo:

| | |
|---|---|
| Insurance | $1,000 |
| Advertising expense | 500 |
| Mortgage interest | 3,500 |
| Property taxes | 900 |
| Repairs & maintenance | 650 |
| Utilities | 950 |
| Depreciation | 8,500 |

**62.** Assume Natalie uses the *Tax Court* method of allocating expenses to rental use of the property.

a. What is the total amount of *for* AGI (rental) deductions Natalie may deduct in the current year related to the condo?
b. What is the total amount of itemized deductions Natalie may deduct in the current year related to the condo?
c. If Natalie's basis in the condo at the beginning of the year was $150,000, what is her basis in the condo at the end of the year?
d. Assume that gross rental revenue was $2,000 (rather than $10,000), what amount of *for* AGI deductions may Natalie deduct in the current year related to the condo?

*Note that the home falls into the residence with significant rental use category*

## Home Ownership. Gain on Sale. Interest on Mortgage

| **I bought the home for \$600,000 and gave a mortgage of \$600,000.**<br>**I now have a mortgage balance \$600,000, with an interest rate of 10%.**<br>**I pay interest-only. The home value has increased to \$1,000,000.**<br>**I (or we) have owned this home & lived only in this home for five years.** | **Home**<br>**Cost \$600,000**<br>**Value \$1,000,000** |
|---|---|

## Part 1. How much gain do I recognize on sale of home (etc.)? (Basic: Sec. 61, 1001)

**Case 1.** I am single. The home is sold at FMV. **Sec. 121(a), (b)(1)**

**Case 2.** I am single. The home is sold at FMV. (Assume I owned it for 1 year – discuss.)
**Sec. 121(a), (b)(1). Also Sec. 121(c), especially (c)(2)(B). Reg. 1.121-3(b)**

**Case 3.** My wife and I have owned and lived in the home for 5 years.
We file a joint return. We sell the home at FMV. **Sec. 121(a), (b)(2)(A)**

**Case 4.** I have owned the home for 5 years. My wife and I have lived in the home for 5 years
We file separate returns. We sell the home at FMV. How much gain is included in my income?
**Sec. 121(a), (b)(1)**

**Case 5.** I have owned and lived in the home for 5 years.
**I was single until my wedding to Mary one year ago.**
**Mary moved into the house (from her apartment) immediately after our wedding.**
We file a joint return. I sell the home at FMV. How much gain is included in our income?
**Sec. 121(a), (b)(1), Sec. 121(b)(2)(B)**

**Case 6.** I have owned the home for 5 years.
Mary and I had lived together in the house for five years.
We were married one year ago. She has continued to live with me in the home.
We file a joint return for 2017. I sell the home at FMV. Sec. 121(a), (b)(2)(A)

**Case 7.** My wife and I owned and lived in the home for 5 years.
Wife had an auto accident and was killed in an auto accident in December, 2016.
I filed a joint return for 2016. We "planned to sell" the home at FMV.
I sold the house in January, 2017. Sec. 121(a), (b)(1), (b)(4)

**Case 8.** We encounter an economic crisis and the value of the home falls to \$500,000.
The bank agrees to allow me to sell the home for \$500,000 and apply the \$500,000 selling price to
to the \$600,000 mortgage payable. Bank forgave the remaining balance of the mortgage (\$100,000).
Do I recognize a loss on the sale? [Sec. 1221, 1211]
Do I recognize a gain on forgiveness of debt under **Sec. 61(a)(12)? Sec. 108(a)(1(E), (h)(2).**
(Suppose we had paid the mortgage down to a \$450,000 balance. Then we borrowed \$150,000 for vacations.
Mortgage loan balance increased to \$600,000 shown above.) Note-law (exclusion) expired in 2014.

# Home Ownership. Gain on Sale. Interest on Mortgage (Continued)

## Part 2. How much mortgage interest do I deduct (assume home is not sold)?

**Case 1.** I am single. How much mortgage interest expense is deducted on my return?
**Sec. 163(h)(1), Sec. 163(h)(2)(D), Sec. 163(h)(3)(A), (B)**

**Case 2.** I am single. For this part only, assume that I borrowed $600,000 from my brokerage account to buy the home. The interest rate is 10% and I made interest payments only.
No mortgage was given when I borrowed the money. How much interest is deducted on my return?
**Sec. 163(h)(3)(B)(i)(II)**

**Case 3.** My wife and I have owned and lived in the house for 5 years.
We file a joint return. How much interest is deducted on my return?
**Sec. 163(h)(1), Sec. 163(h)(2)(D), Sec. 163(h)(3)(A), (B)**

**Case 4.** My wife and I have owned and lived in the house for 5 years. We refinanced the loan on the first day of the year, borrowing $900,000, (1) paying off the $600,000 mortgage, and (2) using $300,000 to make gifts to our children.
We file a joint return. How much is our interest is deduction?
**Sec. 163(h)(1), Sec. 163(h)(2)(D), Sec. 163(h)(3)(A), (B)(i)(II)**

**Case 5.** (Ignore change in Case 4.) My wife and I have owned and lived in the house for 5 years.
I pay the interest. We file separate returns. How much interest is deducted on my return?
**Sec. 163(h)(1), Sec. 163(h)(2)(D), Sec. 163(h)(3)(A), (B)(i), (ii)**

**Case 6**. I was married throughout the year, until my divorce became final on December 31.
I own the house, I make mortgage principal and interest payments.
I live in California. How much interest is deducted on my return?

**Case 7.** My wife and I have owned and lived in the house for 5 years. We file a joint return.
On the first day of the year, we bought a "second" home for $750,000, paying $50,000 down and giving a mortgage of $700,000.
Interest rate is 10% on the mortgage on the second home.
How much interest is deducted on my return?
What issues are encountered if the mortgage on the second home has an interest rate of 6%?

## Sec. 121. Exclusion of Gain from Sale of Principal Residence

**(a) Exclusion.** Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

**(b) Limitations**

**(1) In general.** The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed $250,000.

**(2) Special rules for joint returns.** In the case of a husband and wife who make a joint return for the taxable year of the sale or exchange of the property—

**(A) $500,000 limitation for certain joint returns.** Paragraph (1) shall be applied by substituting "$500,000" for "$250,000" if—

**(i)** either spouse meets the ownership requirements of subsection (a) with respect to such property;

**(ii)** both spouses meet the use requirements of subsection (a) with respect to such property; and

**(iii)** neither spouse is ineligible for the benefits of subsection (a) with respect to such property by reason of paragraph (3).

**(B) Other joint returns.** If such spouses do not meet the requirements of subparagraph (A), the limitation under paragraph (1) shall be the sum of the limitations under paragraph (1) to which each spouse would be entitled if such spouses had not been married. For purposes of the preceding sentence, each spouse shall be treated as owning the property during the period that either spouse owned the property.

**(3) Application to only 1 sale or exchange every 2 years.**

**(A) In general.** Subsection (a) shall not apply to any sale or exchange by the taxpayer if, during the 2-year period ending on the date of such sale or exchange, there was any other sale or exchange by the taxpayer to which subsection (a) applied.

**(B) Pre-May 7, 1997**, sales not taken into account. Subparagraph (A) shall be applied without regard to any sale or exchange before May 7, 1997.

**(4) Special rule for certain sales by surviving spouses.** In the case of a sale or exchange of property by an unmarried individual whose spouse is deceased on the date of such sale, paragraph (1) shall be applied by substituting "$500,000" for "$250,000" if such sale occurs not later than 2 years after the date of death of such spouse and the requirements of paragraph (2)(A) were met immediately before such date of death.

**[(5)] Exclusion of gain allocated to nonqualified use.**

**(A) In general.** Subsection (a) shall not apply to so much of the gain from the sale or exchange of property as is allocated to periods of nonqualified use.

**(B) Gain allocated to periods of nonqualified use**. For purposes of subparagraph (A), gain shall be allocated to periods of nonqualified use based on the ratio which—

**(i)** the aggregate periods of nonqualified use during the period such property was owned by the taxpayer, bears to

**(ii)** the period such property was owned by the taxpayer.

**(C) Period of nonqualified use.** For purposes of this paragraph—

**(i) In general**. The term "period of nonqualified use" means any period (other than the portion of any period preceding January 1, 2009) during which the property is not used as the principal residence of the taxpayer or the taxpayer's spouse or former spouse.

**(ii) Exceptions.** The term "period of nonqualified use" does not include—

**(I)** any portion of the 5-year period described in subsection (a) which is after the last date that such property is used as the principal residence of the taxpayer or the taxpayer's spouse,

**(II)** any period (not to exceed an aggregate period of 10 years) during which the taxpayer or the taxpayer's spouse is serving on qualified official extended duty (as defined in subsection (d)(9)(C)) described in clause (i), (ii), or (iii) of subsection (d)(9)(A), and

**(III)** any other period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or such other

unforeseen circumstances as may be specified by the Secretary.

**(D) Coordination with recognition of gain attributable to depreciation**. For purposes of this paragraph—

**(i)** subparagraph (A) shall be applied after the application of subsection (d)(6), and

**(ii)** subparagraph (B) shall be applied without regard to any gain to which subsection (d)(6) applies.

**(c) Exclusion for Taxpayers Failing To Meet Certain Requirements.**

**(1) In general**. In the case of a sale or exchange to which this subsection applies, the ownership and use requirements of subsection (a), and subsection (b)(3), shall not apply; but the **dollar limitation under paragraph (1) or (2) of subsection (b), whichever is applicable, shall be equal to**—

**(A)** the amount which bears the same ratio to such limitation (determined without regard to this paragraph) as

**(B)**

**(i)** the shorter of—

**(I)** the aggregate periods, during the 5-year period ending on the date of such sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence; or

**(II)** the period after the date of the most recent prior sale or exchange by the taxpayer to which subsection (a) applied and before the date of such sale or exchange, bears to

**(ii)** 2 years.

**(2) Sales and exchanges to which subsection applies**. This subsection shall apply to any sale or exchange if—

**(A)** subsection (a) would not (but for this subsection) apply to such sale or exchange by reason of—

**(i)** a failure to meet the ownership and use requirements of subsection (a), or

**(ii)** subsection (b)(3), and

**(B)** such sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.



## (d) Special Rules.

**(1) Joint returns**. If a husband and wife make a joint return for the taxable year of the sale or exchange of the property, subsections (a) and (c) shall apply if either spouse meets the ownership and use requirements of subsection (a) with respect to such property.

**(2) Property of deceased spouse.** For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, the period such unmarried individual owned and used such property shall include the period such deceased spouse owned and used such property before death.

**(3) Property owned by spouse or former spouse.** For purposes of this section—

**(A) Property transferred to individual from spouse or former spouse**. In the case of an individual holding property transferred to such individual in a transaction described in section 1041(a), the period such individual owns such property shall include the period the transferor owned the property.

**(B) Property used by former spouse pursuant to divorce decree, etc.** Solely for purposes of this section, an individual shall be treated as using property as such individual's principal residence during any period of ownership while such individual's spouse or former spouse is granted use of the property under a divorce or separation instrument (as defined in section 71(b)(2)).

**(4) Tenant-stockholder in cooperative housing corporation.** For purposes of this section, if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then—

**(A)** the holding requirements of subsection (a) shall be applied to the holding of such stock, and

**(B)** the use requirements of subsection (a) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

**(5) Involuntary conversions.**

**(A) In general.** For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

**(B) Application of section 1033**. In applying section 1033 (relating to involuntary conversions), the amount realized from the sale

or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to this section.

**(C) Property acquired after involuntary conversion.** If the basis of the property sold or exchanged is determined (in whole or in part) under section 1033(b) (relating to basis of property acquired through involuntary conversion), then the holding and use by the taxpayer of the converted property shall be treated as holding and use by the taxpayer of the property sold or exchanged.

**(6) Recognition of gain attributable to depreciation**. Subsection (a) shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, in respect of such property.

**(7) Determination of use during periods of out-of-residence care**. In the case of a taxpayer who—

**(A)** becomes physically or mentally incapable of self-care, and

**(B)** owns property and uses such property as the taxpayer's principal residence during the 5-year period described in subsection (a) for periods aggregating at least 1 year, then the taxpayer shall be treated as using such property as the taxpayer's principal residence during any time during such 5-year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

**(8) Sales of remainder interests**. For purposes of this section—

**(A) In general**. At the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of such interest being a remainder interest in such residence, but this section shall not apply to any other interest in such residence which is sold or exchanged separately.

**(B) Exception for sales to related parties.** Subparagraph (A) shall not apply to any sale to, or exchange with, any person who bears a relationship to the taxpayer which is described in section 267(b) or 707(b).

**(9) Uniformed services, foreign service, and intelligence community.**

**(A) In general**. At the election of an individual with respect to a property, the running of the 5-year period described in subsections (a) and (c)(1)(B) and paragraph (7) of this subsection with respect to such property shall be suspended during any period that such individual or such individual's spouse is serving on qualified official extended duty-

**(i)** as a member of the uniformed services,

**(ii)** as a member of the Foreign Service of the United States, or

**(iii)** as an employee of the intelligence community.

**(B) Maximum period of suspension**. The 5-year period described in subsection (a) shall not be extended more than 10 years by reason of subparagraph (A).

**(C) Qualified official extended duty**. For purposes of this paragraph—

**(i) In general**. The term "qualified official extended duty" means any extended duty while serving at a duty station which is at least 50 miles from such property or while residing under Government orders in Government quarters.

**(ii) Uniformed services**. The term "uniformed services" has the meaning given such term by section 101(a)(5) of title 10, United States Code, as in effect on the date of the enactment of this paragraph.

**(iii) Foreign service of the United States.** The term "member of the Foreign Service of the United States" has the meaning given the term "member of the Service" by paragraph (1), (2), (3), (4), or (5) of section 103 of the Foreign Service Act of 1980, as in effect on the date of the enactment of this paragraph.

**(iv) Employee of intelligence community.** The term "employee of the intelligence community" means an employee (as defined by section 2105 of title 5, United States Code) of—

**(I)** the Office of the Director of National Intelligence,

**(II)** the Central Intelligence Agency,

**(III)** the National Security Agency,

**(IV)** the Defense Intelligence Agency,

**(V)** the National Geospatial-Intelligence Agency,

**(VI)** the National Reconnaissance Office,

**(VII)** any other office within the Department of Defense for the collection of specialized national intelligence through reconnaissance programs,

**(VIII)** any of the intelligence elements of the Army, the Navy, the Air Force, the Marine Corps, the Federal Bureau of Investigation, the Department of Treasury, the Department of Energy, and the Coast Guard,

**(IX)** the Bureau of Intelligence and Research of the Department of State, or

**(X)** any of the elements of the Department of Homeland Security concerned with the analyses of foreign intelligence information.

**(v) Extended Duty**. The term "extended duty" means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.

**(D) Special rules relating to election.**

**(i) Election limited to 1 property at a time**. An election under subparagraph (A) with respect to any property may not be made if such an election is in effect with respect to any other property.

**(ii) Revocation of election.** An election under subparagraph (A) may be revoked at any time.

**(10) Property acquired in like-kind exchange**. If a taxpayer acquires property in an exchange with respect to which gain is not recognized (in whole or in part) to the taxpayer under subsection (a) or (b) of section 1031, subsection (a) shall not apply to the sale or exchange of such property by such taxpayer (or by any person whose basis in such property is determined, in whole or in part, by reference to the basis in the hands of such taxpayer) during the 5-year period beginning with the date of such acquisition.

**(11) Property acquired from a decedent**. The exclusion under this section shall apply to property sold by—

**(A)** <u>the estate of a decedent</u>,

**(B)** any individual who acquired such property from the decedent (within the meaning of section 1022), and

**(C)** a trust which, immediately before the death of the decedent, was a qualified revocable trust (as defined in section 645(b)(1)) established by the decedent,

determined by taking into account the ownership and use by the decedent.

**(12) Peace corps.**

**(A) In general**. At the election of an individual with respect to a property, the running of the 5-year period described in subsections (a) and (c)(1)(B) and paragraph (7) of this subsection with respect to such property shall be suspended during any period that such individual or such individual's spouse is serving outside the United States—

**(i)** on qualified official extended duty (as defined in paragraph (9)(C)) as an employee of the Peace Corps, or

**(ii)** as an enrolled volunteer or volunteer leader under section 5 or 6 (as the case may be) of the Peace Corps Act (22 U.S.C. 2504, 2505).

**(B) Applicable rules**. For purposes of subparagraph (A), rules similar to the rules of subparagraphs (B) and (D) shall apply.

**<u>(e) Denial of Exclusion for Expatriates.</u>** This section shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) applies to such individual.

**<u>(f) Election To Have Section Not Apply.</u>** This section shall not apply to any sale or exchange with respect to which the <u>taxpayer elects not to have this section apply</u>.

**<u>(g) Residences Acquired in Rollovers Under Section 1034</u>.** For purposes of this section, in the case of property the acquisition of which by the taxpayer resulted under section 1034 (as in effect on the day before the date of the enactment of this section) in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, in determining the period for which the taxpayer has owned and used such property as the taxpayer's principal residence, there shall be included the aggregate periods for which such other residence (and each prior residence taken into account under section 1223(6) in determining the holding period of such property) had been so owned and used.

## Home Mortgage Interest Expense Materials

| | | | | | |
|---|---|---|---|---|---|
| 163(h)(3) | 1. | Name two types of interest on a home that are deductible. Sec. 163(h)(3)(B) & ( C) | | | |
| 163(h)(1) | 2. | Personal interest is not deductible. Give some examples. | | | |
| 163(h)(2) | 3. | List six types of deductible interest below. What form is used for reporting? | | | |
| | | **1.** | C, F | **4.** | A |
| | | **2.** | A | **5.** | 1040-P1 |
| | | **3.** | E | **6.** | |
| | 4. | **Where** are these types of interest reported on the tax return? Form 1040 & Sch A,C,E | | | |

| | | | |
|---|---|---|---|
| **Mr. & Ms. Challenge file jointly and have no dependent. Their salaries total:** | | | $500,000 |
| | Note: Most of first year mortgage payments go for interest. We assume 100% in Case 1 | | |
| | **Case 1.** Date of purchase of new home | | 1/1/2017 |
| | Purchase price of new home | | $400,000 |
| | Down payment | | $100,000 |
| | **Balance Financed with mortgage on home** | | **$300,000** |
| 461(g) | Points paid to get the loan- paid in cash - common business practice | | 3 |
| | Rate of interest on loan (paid with each monthly payment starting on 1-31-2017.) | | 10% |
| | Interest for first year according to amortization table | | |
| | a. | What is the interest deduction for the first year (before phase-out- Sec. 68)? | |
| 163(h)(3)(B) | b. | What if the home cost $1,400,000 ($200,000 down payment, 10% int. rate), 3pts? | |
| | c. | Assume the loan was unsecured. What is the impact (if any) of this fact? | |
| | **Case 2 - Continue Case 1 as originally presented.** | | |
| | Date of second mortgage on home described above | | 1/5/2017 |
| | Amount of second mortgage loan | | $50,000 |
| | Rate of interest on second loan | | 12% |
| 163(h)(3)(A)(ii) | Purpose of the loan is to pay for | | **New Car** |
| | How much of this interest is deductible? Why? | | |
| | **Case 3. Ignore case 2** | | |
| | By July 1, 2018, the original mortgage loan had a balance of | | $280,000 |
| | By July 1, 2018, the home had a fair market value of | | $425,000 |
| 163(h)(4)(A) | On July 1, 2018, taxpayer borrowed (and gave a second mortgage) | | $125,000 |
| | Second Mortgage rate (paid with each monthly payment starting on 7-31-2018.) | | 10% |
| | The money was used to buy these assets for their home | | **Paintings** |
| 163(h)(3)(C) | a. | How much interest on this loan is deductible? | |
| 163(h)(3)(C) | b. | The home's value on July 1, 2018 was | $375,000 |
| | | **Equity is $95,000. Half year.** | |
| 163(h)(2)(C) | c. | What if proceeds were used to buy rental property? | |
| 163(d) | d. | What if proceeds were used to buy IBM stock? | |
| | **Case 4. Ignore cases 2 and 3. Continue Case 1 as originally presented.** | | |
| | Date of purchase of second home at the beach | | **1/1/2017** |
| | Purchase price of beach home | | $300,000 |
| | Down payment | | $100,000 |
| | Balance financed with mortgage on beach home | | **$200,000** |
| | Rate of interest on loan (paid with each monthly payment starting on 1-31-2017) | | 10% |
| | Interest for first year according to amortization table | | $20,000 |
| 163(h)(4)(A) | Time spent at the beach home in 2017 (beach home was not rented in 2017). | | 2 weeks |
| | **What is interest deduction for this loan (before phase-out)? 163(h)(4)(A)(iii)** | | |
| 163(h)(3)(E) | **Case 5. Taxpayer paid mortgage insurance premiums of $500. Deductible Amount?** | | |
| 1.163-9T | **Case 6. Taxpayer paid interest of $1,000 on prior year income tax. Deduct?** | | |

## 163(h) Disallowance of Deduction for Personal Interest.

**(1) In general.** In the case of a taxpayer other than a corporation, no deduction shall be allowed under this chapter for personal interest paid or accrued during the taxable year.

**(2) Personal interest.** For purposes of this subsection, the term "personal interest" means any interest allowable as a deduction under this chapter other than—

**(A)** interest paid or accrued on indebtedness properly allocable to a trade or business (other than the trade or business of performing services as an employee),

**(B)** any investment interest (within the meaning of subsection (d)),

**(C)** any interest which is taken into account under section 469 in computing income or loss from a passive activity of the taxpayer,

**(D) any qualified residence interest (within the meaning of paragraph (3)),**

**(E)** any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6163, and

**(F)** any interest allowable as a deduction under section 221 (relating to interest on educational loans).

### (3) Qualified residence interest.

For purposes of this subsection—

**(A) In general**. The term "qualified residence interest" means any interest which is paid or accrued during the taxable year on—

**(i) acquisition indebtedness** with respect to any qualified residence of the taxpayer, or

**(ii) home equity indebtedness** with respect to any qualified residence of the taxpayer.

For purposes of the preceding sentence, the determination of whether any property is a qualified residence of the taxpayer shall be made as of the time the interest is accrued.

### (B) Acquisition indebtedness.

**(i) In general.** The term **"acquisition indebtedness"** means any indebtedness which—

**(I)** is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, and

**(II)** is secured by such residence.

Such term also includes any indebtedness secured by such residence resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence (or this sentence); but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

**(ii)$1,000,000 limitation.** The aggregate amount treated as acquisition indebtedness for any period shall not exceed $1,000,000 ($500,000 in the case of a married individual filing a separate return).

### (C) Home equity indebtedness.

**(i) In general.** The term **"home equity indebtedness"** means any indebtedness (other than acquisition indebtedness) secured by a qualified residence to the extent the aggregate amount of such indebtedness does not exceed-

**(I)** the fair market value of such qualified residence, reduced by

**(II)** the amount of acquisition indebtedness with respect to such residence.

**(ii) Limitation—**The aggregate amount treated as home equity indebtedness for any period shall not exceed $100,000 ($50,000 in the case of a separate return by a married individual).

**(D) Treatment of indebtedness incurred on or before October 13, 1987.—**

**(i) In general.** In the case of any pre-October 13, 1987, indebtedness—

**(I)** such indebtedness shall be treated as acquisition indebtedness, and

**(II)** the limitation of subparagraph (B)(ii) shall not apply.

**(ii) Reduction in $1,000,000 limitation.** The limitation of subparagraph (B)(ii) shall be reduced (but not below zero) by the aggregate amount of outstanding pre-October 13, 1987, indebtedness.

**(iii) Pre-October 13, 1987, indebtedness**. The term "pre-October 13, 1987, indebtedness" means—

**(I)** any indebtedness which was incurred on or before October 13, 1987, and which was secured by a qualified residence on October 13, 1987, and at all times thereafter before the interest is paid or accrued, or

**(II)** any indebtedness which is secured by the qualified residence and was incurred after October 13, 1987, to refinance indebtedness described in subclause (I) (or refinanced indebtedness meeting the requirements of this subclause) to the extent (immediately after the refinancing) the principal amount of the indebtedness resulting from the refinancing does not exceed the principal amount of the refinanced indebtedness (immediately before the refinancing).

**(iv) Limitation on period of refinancing**. Subclause (II) of clause (iii) shall not apply to any indebtedness after—

**(I)** the expiration of the term of the indebtedness described in clause (iii)(I), or

**(II)** if the principal of the indebtedness described in clause (iii)(I) is not amortized over its term, the expiration of the term of the 1st refinancing of such indebtedness (or if earlier, the date which is 30 years after the date of such 1st refinancing).

**(E) Mortgage insurance premiums treated as interest.**

**(i) In general**. Premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness with respect to a qualified residence of the taxpayer shall be treated for purposes of this section as interest which is qualified residence interest.

**(ii) Phaseout**. The amount otherwise treated as interest under clause (i) shall be reduced (but not below zero) by 10 percent of such amount for each $1,000 ($500 in the case of a married individual filing a separate return) (or fraction thereof) that the taxpayer's adjusted gross income for the taxable year exceeds $100,000 ($50,000 in the case of a married individual filing a separate return).

**(iii) Limitation**. Clause (i) shall not apply with respect to any mortgage insurance contracts issued before January 1, 2007.

**(iv) Termination.** Clause (i) shall not apply to amounts—

**(I)** paid or accrued after December 31, 2013, or

**(II)** properly allocable to any period after such date.

## (4) Other definitions and special rules.

For purposes of this subsection—

# (A) Qualified residence.

**(i) In general.** The term "qualified residence" means—

**(I)** **the principal residence** (within the meaning of section 121) of the taxpayer, and

**(II)** **1 other residence** of the taxpayer which is selected by the taxpayer for purposes of this subsection for the taxable year and which is used by the taxpayer as a residence (within the meaning of section 280A(d)(1)).

**(ii) Married individuals filing separate returns.** If a married couple does not file a joint return for the taxable year—

**(I)** such couple shall be treated as 1 taxpayer for purposes of clause (i), and

**(II)** each individual shall be entitled to take into account 1 residence unless both individuals consent in writing to 1 individual taking into account the principal residence and 1 other residence.

**(iii) Residence not rented.** For purposes of clause (i)(II), notwithstanding section 280A(d)(1), if the taxpayer does not rent a dwelling unit at any time during a taxable year, such unit may be treated as a residence for such taxable year.

**(B) Special rule for cooperative housing corporations.** Any indebtedness secured by stock held by the taxpayer as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as so defined) shall be treated as secured by the house or apartment which the taxpayer is entitled to occupy as such a tenant-stockholder. If stock described in the preceding sentence may not be used to secure indebtedness, indebtedness shall be treated as so secured if the taxpayer establishes to the satisfaction of the

Secretary that such indebtedness was incurred to acquire such stock.

**(C) Unenforceable security interests.** Indebtedness shall not fail to be treated as secured by any property solely because, under any applicable State or local homestead or other debtor protection law in effect on August 16, 1986, the security interest is ineffective or the enforceability of the security interest is restricted.

**(D) Special rules for estates and trusts.** For purposes of determining whether any interest paid or accrued by an estate or trust is qualified residence interest, any residence held by such estate or trust shall be treated as a qualified residence of such estate or trust if such estate or trust establishes that such residence is a qualified residence of a beneficiary who has a present interest in such estate or trust or an interest in the residuary of such estate or trust.

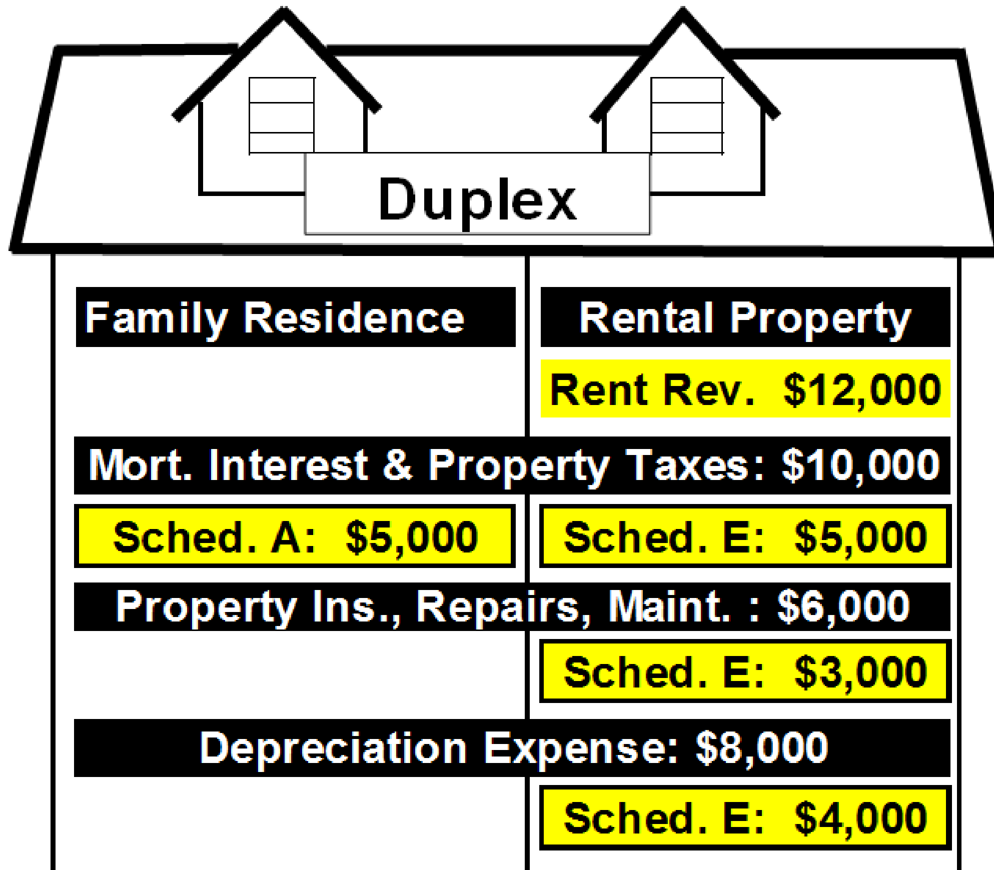
**(E) Qualified mortgage insurance.** The term "qualified mortgage insurance" means—

**(i)** mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and

**(ii)** private mortgage insurance (as defined by section 2 of the Homeowners Protection Act of 1998 (12 U.S.C. 4901), as in effect on the date of the enactment of this subparagraph).

**(F) Special rules for prepaid qualified mortgage insurance.** Any amount paid by the taxpayer for qualified mortgage insurance that is properly allocable to any mortgage the payment of which extends to periods that are after the close of the taxable year in which such amount is paid shall be chargeable to capital account and shall be treated as paid in such periods to which so allocated. No deduction shall be allowed for the unamortized balance of such account if such mortgage is satisfied before the end of its term. The preceding sentences shall not apply to amounts paid for qualified mortgage insurance provided by the Veterans Administration or the Rural Housing Administration.

In a duplex, you have two homes under one roof. In this example, one of the homes is the principal residence of the owner of the duplex, and the other home is rented to a tenant. So this building is partly a personal residence, and partly a rental house. If each "home" or apartment has the same space, you may choose to allocate such items as the property insurance premiums equally to each unit. The premiums allocated to the rental unit would be deductible, but not the amount allocated to the personal residence.




**In the example above, "part" of the building is rented "ALL" of the year.**
**In a vacation home (below) "all" of the building is rented "PART" of the year.**
**And part of the building may be vacant for much of the year, causing allocation challenges.**

## Vacation Home Rules

| | | Period Rented To Others | |
|---|---|---|---|
| | | 14 days or less | 15 days or more |
| Time of | Not more than greater of 14 days or 10% of total days rented | 1<br>Sec. 183(Hobby Rules) | 2<br>Sec. 183(Hobby Rules) |
| Personal Use | More than greater of 14 days or 10% of total days rented | 3<br>Sec. 280A(g) | 4<br>Sec. 280A-Gen. Rule |

# VACATION HOME

| Home Use: | Problem Data | |
|---|---|---|
| Days of Personal Use | 30 | The tax rules covering this problem are in IRC Section 280A. Note that there are two ways to allocate interest and taxes between rental and personal use. See Textbook. Repeat this with IRS Approach. |
| Days Rented | 60 | |
| Total Days Used | 90 | |
| Rev. & Exp. shown below | | |

## Vacation Home for Sue

| Revenue and Expenses | Total | Schedule E | | | Schedule A | | |
|---|---|---|---|---|---|---|---|
| | | Fraction | | Rental | Fraction | | Personal |
| Revenue | $5,000 | | | $5,000 | | | |
| 1. Interest | 7,000 | / | | | / | | |
| 2. Taxes | 2,300 | / | | | / | | |
| Total Interest & Taxes | 9,300 | | | | | | |
| Subtotal | | | | | | | |
| 3. Other Exp. except Deprec. | 2,400 | / | | | | | |
| Net Income Before De | | | | | | | |
| 4. Depreciation Expense | 9,000 | / | | | | | |
| Limit on Depreciation | | | | | | | |
| Net Income or Loss | | | | | | | |

Please fill in the missing numbers for the rental part (Schedule E) and the personal part (Schedule A). Note that only in interest and taxes (and casualty losses) are deductible for the property on Schedule A. Those are the expenses that are deductible whether the property is used for rental or not.

# VACATION HOME-Bolton Method

| Use of Vacation Home: | Problem Data |
|---|---|
| Days of Personal Use | 20 |
| Days Rented | 60 |
| Total Days Used | 80 |
| See Total Column for other details | |

The tax rules covering this problem are in IRC Section 280A. Note that there are two ways to allocate interest and taxes between rental and personal use. See Textbook. Repeat this with IRS Approach.

| Revenue & Expenses: | | Schedule E | | | | Schedule A | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total | Fraction | | | Rental | Fraction | | | Personal |
| Revenue | $9,000 | | | | $9,000 | | | | |
| 1. Interest | 5,000 | 60 | / | 365 | 822 | 305 | / | 365 | $4,178 |
| 2. Taxes | 3,000 | 60 | / | 365 | 493 | 305 | / | 365 | 2,507 |
| Total Interest and Taxes | 8,000 | | | | 1,315 | | | | $6,685 |
| Net Income after Taxes & Interest | | | | | 7,685 | | | | |
| 3. Other Expenses except Deprec. | 2,000 | 60 | / | 80 | 1,500 | | | | |
| Net Income Before Depreciation | | | | | 6,185 | | | | |
| 4. Depreciation Expense | 10,000 | 60 | / | 80 | 7,500 | | | | |
| Limit on Depreciation deduction | | | | | 6,185 | | | | |
| Net Income or Loss | | | | | $0 | | | | |

# VACATION HOME-IRS Method

| Use of Vacation Home: | Problem Data |
|---|---|
| Days of Personal Use | 35 |
| Days Rented | 75 |
| Total Days Used | 110 |
| See Total Column for other details | |

The tax rules covering this problem are in IRC Section 280A. Note that there are two ways to allocate interest and taxes between rental and personal use. See Textbook. Repeat this with IRS Approach.

| Revenue & Expenses: | | Schedule C | | | | Schedule A | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total | Fraction | | | Bus. | Fraction | | | Personal |
| Revenue | $10,000 | | | | $9,000 | | | | |
| Advertising | $500 | | | | $500 | | | | |
| 1. Interest | 3,500 | 75 | / | 110 | 2,386 | 35 | / | 110 | $1,114 |
| 2. Taxes | 900 | 75 | / | 110 | 614 | 35 | / | 110 | 286 |
| Total Interest and Taxes | 4,400 | | | | 3,000 | | | | $1,400 |
| Net Income after Taxes & Interest | | | | | 6,000 | | | | |
| 3. Other Expenses except Deprec. | 2,600 | 75 | / | 110 | 1,773 | | | | |
| Net Income Before Depreciation | | | | | 4,227 | | | | |
| 4. Depreciation Expense | 8,500 | 75 | / | 110 | 5,795 | | | | |
| Limit on Depreciation deduction | | | | | 4,227 | | | | |
| Net Income or Loss | | | | | $0 | | | | |

| One room of home used as primary location for a (Schedule C) business. | | Regular Method | Rev. Proc 2013-13 |
|---|---|---|---|
| Revenue | | $9,000 | $9,000 |
| Supplies and advertising | | ($2,300) | ($2,300) |
| Postage and subscriptions | | ($1,700) | ($1,700) |
| Net income before home office deduction | | $5,000 | $5,000 |
| Her home has 6 rooms, with total of 2,500 square feet. | Sq. Ft. | 2,500 | 2,500 |
| Office area is 500 square feet or 20% of the total area. | Sq. Ft. | 500 | 500 |
| Mortgage interest and real estate taxes | | $12,000 | $15,000 |
| Insurance, repairs, & maintenance related to home. | | $8,000 | $8,000 |
| Depreciation on entire house for the current year is | | $6,000 | $6,000 |
| | | $26,000 | $29,000 |
| | | 20% | 20% |
| | | $5,200 | $5,800 |
| | | | |
| **What is the home office deduction for the current year?** | | | |
| **Percentage of area of home used for office** | | 20% | |
| **1. Expenses otherwise allowed under other tax rules:** | | | |
| Rules other than Section 280A | | | |
| Mortgage interest and taxes allocable to office | | $2,400 | |
| Balance of Income (limit on remaining expenses) | | $2,600 | |
| | | | |
| **2. Deduct office expenses not otherwise allowed as a deduction:** | | | |
| Insurance, repairs, and other expenses | | $1,600 | |
| Balance of Income (limit on remaining expenses) | | $1,000 | |
| | | | |
| **3. Deduct depreciation on office portion of residence:** | | | |
| Actual amount of depreciation allocated to office | | $1,200 | |
| Limit on Depreciation Deduction | | $1,000 | |
| | | | |
| Total home office expenses incurred | | $5,200 | |
| Total home office expenses deducted | | $5,000 | $1,500 |
| Amount carred to next year | | $200 | |
| | | | |
| Under Rev. Proc. 2013-13, Mortgage interest property taxes and casualty losses are on Schedule A | | | |

# Selected Multiple-Choice Homework Problems

8

| Sale of Residence - Jamie | |
|---|---|
| Selling price of house | ? |
| Selling expenses | ? |
| Amount realized | ? |
| Basis of old house | ? |
| Gain Realized | ? |
| Gain - General Rule | $35,000 |
| Numerator | 3 |
| Denominator | 24 |
| % of exclusion | 13% |
| Maximum Exclusion | 250,000 |
| Exclusion allowed | 31,250 |
| Gain recognized | $3,750 |

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| Sale of residence with nonqualified use | | | Used as Residence | (Nonqualified) Rental use |
|---|---|---|---|---|
| Purchase date | | 7/1/2006 | | |
| Used as residence | Start | 7/1/2006 | | |
| | End | 7/1/2013 | 7 years | |
| House is rented | Start | 7/1/2013 | | |
| | End | 7/1/2015 | | 2 years |
| Used as residence | Start | 7/1/2015 | | |
| | End | 7/1/2016 | 1 Year | |
| Total period of ownership | | | 8 years | 2 years |

| | Years | Months | |
|---|---|---|---|
| Total period of ownership | 10 | 120 | |
| Total period of nonqualifed use | 2 | 24 | |
| Nonqualifed use percentage | 20% | | Reduces actual gain, for exclusion |
| Selling price of home | | | |
| Cost of home | | | |
| Gain realized | $210,000 | | |
| Nonqualifed use percentage | 20% | | |
| Reduction of potential exclusion | $42,000 | | |
| Potential gain exclusion | $168,000 | | |
| Maximum gain exclusion | $250,000 | | |
| Actual gain exclusion | $168,000 | | |

15

| Residence interest deduction limits<br>Transaction or information | Amount | Acquisition Debt | Other Debt | |
|---|---|---|---|---|
| Purchase price | $600,000 | | | |
| Down Payment | ($100,000) | | | |
| Amount of initial mortgage | $500,000 | $500,000 | | Would be acquisition |
| Additional borrowing | $75,000 | | $75,000 | debt if cash used to |
| | | | | improve home. |
| Total debt | | $500,000 | $75,000 | |
| Debt for computing Residence Interest | | $500,000 | $75,000 | |
| Interest rate | | 6% | 8% | |
| Interest paid | $33,000 | $30,000 | $3,000 | Half year |

No limit here because acquisition debt did not exceed $1,000,000 and home equity debt did not exceed $100,000. Taxpayer had home equity greater than $75,000 on date of loan.

(If married filing separately, home equity debt for computing interest deduction would be limited to $50,000.)

## Selected Multiple-Choice Homework Problems

18

| Residence interest deduction limits | | | Acquisition | Other Debt |
|---|---|---|---|---|
| Transaction or information | | Amount | Debt | Home Equity |
| Purchase price | | $500,000 | | |
| Down Payment | | ($200,000) | | |
| Amount of initial mortgage | | $300,000 | $300,000 | |
| Additional borrowing | 7/1/2015 | $125,000 | | $125,000 |
| | | | | |
| Total debt | 12/31/2015 | $425,000 | $300,000 | $125,000 |
| Debt for computing Res. Interest | | $400,000 | $300,000 | $100,000 |
| Fraction of year | | | | 50% |
| Interest rate | | | 6% | 8% |
| Total Interest actually paid | | $23,000 | $18,000 | $5,000 |
| Amount of Interest deductible | | $22,000 | $18,000 | $4,000 |

Would be acquisition debt if cash is used to improve home.

Note: solution above is the chronological method.

| Average method- text page 14-11 | |
|---|---|
| Debt for computing Res. Interest | $400,000 |
| Total debt | $425,000 |
| Percentage | 94.12% |
| Total interest paid | $23,000 |
| Interest deduction with this method | $21,647 |

You expect to want to use more of the 8% loan in the mix, but (here) that loan was for 6 months (4%).

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| Residence interest deduction limits | | Acquisition | Acquisition | Other Debt |
|---|---|---|---|---|
| Transaction or information | Amount | Debt | Debt - 2 | Home Equity |
| Purchase price | $1,000,000 | | | |
| Down Payment | ($200,000) | | | |
| Amount of initial mortgage | $800,000 | $800,000 | | |
| Principal payments | ($200,000) | ($200,000) | | |
| Balances | $600,000 | $600,000 | | |
| Refinance acquisition debt | | ($600,000) | $600,000 | $400,000 |
| Total debt | $1,000,000 | $0 | $600,000 | $400,000 |
| Debt for computing Res. Interest | $700,000 | $0 | $600,000 | $100,000 |

23 Points

| | | |
|---|---|---|
| Loan amount | | $200,000 |
| Points | 3 | 3% |
| Points paid | | $6,000 |

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| | |
|---|---|
| Loss from rental activity. | $15,000 |
| AGI | $140,000 |
| Maximum loss write-off | $25,000 |
| Threshhold | 100,000 |
| Phase-out percentage | 50% |
| AGI- above threshhold | 40,000 |
| Reduction in max loss | 20,000 |
| Maximum write-off | $5,000 |

See. Sec. 469(i)

# Committee Reports on P.L. 105-34 (Taxpayer Relief Act of 1997), Congress (United States)

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**.028 Exclusion of gain on sale of principal residence.**—Under the bill a taxpayer generally is able to exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. The exclusion is allowed each time a taxpayer selling or exchanging a principal residence meets the eligibility requirements, but generally no more frequently than once every two years. The bill provides that gain would be recognized to the extent of any depreciation allowable with respect to the rental or business use of such principal residence for periods after May 6, 1997.

To be eligible for the exclusion, a taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or other unforseen circumstances is able to exclude the fraction of the $250,000 ($500,000 if married filing a joint return) equal to the fraction of two years that these requirements are met.

In the case of joint filers not sharing a principal residence, an exclusion of $250,000 is available on a qualifying sale or exchange of the principal residence of one of the spouses. Similarly, if a single taxpayer who is otherwise eligible for an exclusion marries someone who has used the exclusion within the two years prior to the marriage, the bill would allow the newly married taxpayer a maximum exclusion of $250,000. Once both spouses satisfy the eligibility rules and two years have passed since the last exclusion was allowed to either of them, the taxpayers may exclude $500,000 of gain on their joint return.

Under the proposal, the gain from the sale or exchange of the remainder interest in the taxpayer's principal residence may qualify for the otherwise allowable exclusion.

*Effective date*.—The provision is available for all sales or exchanges of a principal residence occurring on or after May 7, 1997, and replaces the present-law rollover and one-time exclusion provisions applicable to principal residences.

A taxpayer could elect to apply present law (rather than the new exclusion) to a sale or exchange (1) made before the date of enactment of the Act, (2) made after the date of enactment pursuant to a binding contract in effect on the date or (3) where the replacement residence was acquired on or before the date of enactment (or pursuant to a binding contract in effect of the date of enactment) and the rollover provision would apply. If a taxpayer acquired his or her current residence in a rollover transaction, periods of ownership and use of the prior residence would be taken into account in determining ownership and use of the current residence. **—House Committee Report**.

*Senate Amendment.*—The Senate amendment is the same as the House bill with technical modifications.

*Conference Agreement*.—The conference agreement generally follows the House bill and the Senate amendment.

The conferees wish to clarify that the provision limiting the exclusion to only one sale every two years by the taxpayer does not prevent a husband and wife filing a joint return from each excluding up to $250,000 of gain from the sale or exchange of each spouse's principal residence provided that each spouse would be permitted to exclude up to $250,000 of gain if they filed separate returns.— **Conference Committee Report**.

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# Joint Committee Summary of P.L. 110-289 (Housing Assistance Tax Act of 2008), Congress (United States)

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**.0235 Exclusion of Gain From Sale of Principal Residence Allocated to Nonqualified Use—**

***Present Law***

**In general**

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

Present law also contains an election relating to members of the uniformed services, the Foreign Service, and certain employees of the intelligence community. [88] If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to 10 years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty. For these purposes, qualified official extended duty is any period of extended duty while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in government furnished quarters. The election may be made with respect to only one property for a suspension period.

The exclusion does not apply to gain to the extent the gain is attributable to depreciation allowable with respect to the rental or business use of a principal residence for periods after May 6, 1997.

***Explanation of Provision***

Under the bill, gain from the sale or exchange of a principal residence allocated to periods of nonqualified use is not excluded from gross income. The amount of gain allocated to periods of nonqualified use is the amount of gain multiplied by a fraction the numerator of which is the aggregate periods of nonqualified use during the period the property was owned by the taxpayer and the denominator of which is the period the taxpayer owned the property.

A period of nonqualified use means any period (not including any period before January 1, 2009) during which the property is not used by the taxpayer or the taxpayer's spouse or former spouse as a principal residence. For purposes of determining periods of nonqualified use, (i) any period after the last date the property is used as the principal residence of the taxpayer or spouse (regardless of use during that period), and (ii) any period (not to exceed two years) that the taxpayer is temporarily absent by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances, are not taken into account. The present-law election for the uniformed services, Foreign Service and employees of the intelligence community is unchanged.

If any gain is attributable to post-May 6, 1997, depreciation, the exclusion does not apply to that amount of gain, as under present law, and that gain is not taken into account in determining the amount of gain allocated to nonqualified use.

*These provisions may be illustrated by the following examples:*

*Example 1.*–Assume that an individual buys a property on January 1, 2009, for $400,000, and uses it as rental property for two years claiming $20,000 of depreciation deductions. On January 1, 2011, the taxpayer converts the property to his principal residence. On January 1, 2013, the taxpayer moves out, and the taxpayer sells the property for $700,000 on January 1, 2014. As under present law, $20,000 gain attributable to the depreciation

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deductions is included in income. Of the remaining $300,000 gain, 40% of the gain (2 years divided by 5 years), or $120,000, is allocated to nonqualified use and is not eligible for the exclusion. Since the remaining gain of $180,000 is less than the maximum gain of $250,000 that may be excluded, gain of $180,000 is excluded from gross income.

*Example 2*.–Assume that an individual buys a principal residence on January 1, 2009, for $400,000, moves out on January 1, 2019, and on December 1, 2021 sells the property for $600,000. The entire $200,000 gain is excluded from gross income, as under present law, because periods after the last qualified use do not constitute nonqualified use.

***Effective Date***

The provision is effective for sales and exchanges after December 31, 2008. **—Joint Committee on Taxation, Technical Explanation of the *Housing Assistance Tax Act of 2008*, July 23, 2008 (JCX-63-08).**

**Footnotes**

88 The provision relating to employees of the intelligence community is effective for sales and exchanges before January 1, 2011.

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# Revenue Procedures, Rev. Proc. 2013-13, Internal Revenue Service, (Jan. 15, 2013)

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Rev. Proc. 2013-13, I.R.B. 2013-6, January 15, 2013.

Modifying: Rev. Proc. 87-57

[ Code Sec. 280A]
**Deductions: Home office deduction: Optional method.–**

**The IRS has announced a new simplified, optional method of claiming a home office deduction. Under the new procedure, a significantly simplified form is used. The new optional deduction is limited to $1,500 per year based on $5 per square foot for up to 300 square feet. Homeowners using the new option will not be able to depreciate the portion of their home used in a trade or business. However, they will be able to claim allowable mortgage interest, real estate taxes, and casualty losses on the home as itemized deductions on Schedule A of Form 1040. The new option is available beginning with the 2013 return that most taxpayers will file in 2014. Comments are invited prior to April 15, 2013. Rev. Proc. 87-57, 1987-2 CB 687, is modified. Back references: ¶14,854.42 and ¶14,854.56.**

**SECTION 1. PURPOSE**

This revenue procedure provides an optional safe harbor method that individual taxpayers may use to determine the amount of deductible expenses attributable to certain business use of a residence during the taxable year. This safe harbor method is an alternative to the calculation, allocation, and substantiation of actual expenses for purposes of satisfying the requirements of §280A of the Internal Revenue Code. This revenue procedure is effective for taxable years beginning on or after January 1, 2013.

**SECTION 2. BACKGROUND**

.01 Section 280A(a) generally disallows any deduction for expenses related to a dwelling unit that is used as a residence by the taxpayer during the taxable year. However, §280A(c)(1) through (4) allow a deduction for expenses related to certain business or rental use of a dwelling unit, subject to the deduction limitation in §280A(c)(5).

.02 Section 280A(c)(1) permits a taxpayer to deduct expenses that are allocable to a portion of the dwelling unit that is exclusively used on a regular basis (A) as the taxpayer's principal place of business for any trade or business, (B) as a place to meet with the taxpayer's patients, clients, or customers in the normal course of the taxpayer's trade or business, or (C) in the case of a separate structure that is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

.03 Section 280A(c)(2) permits a taxpayer to deduct expenses that are allocable to space within the dwelling unit used on a regular basis for the storage of inventory or product samples held for use in the taxpayer's trade or business of selling products at retail or wholesale, if the dwelling unit is the sole fixed location of the trade or business.

.04 Section 280A(c)(3) permits a taxpayer to deduct expenses that are attributable to the rental of the dwelling unit or a portion of the dwelling unit.

.05 Section 280A(c)(4) permits a taxpayer to deduct expenses that are allocable to the portion of the dwelling unit used on a regular basis in the taxpayer's trade or business of providing day care for children, for individuals who have attained age 65, or for individuals who are physically or mentally incapable of caring for themselves.

.06 Section 280A(c)(5) limits the deductibility of expenses that relate to a use of a dwelling unit described in §280A(c)(1) through (4) to the gross income derived from that use for the taxable year reduced by (1) the deductions allocable to the use that are allowable for the taxable year whether or not the unit is used as

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# Chapter 14. Home Ownership

**LO 1** **Determine whether a home is principal residence, residence (not principal), or non-residence for tax purposes.**

**LO 2** **Compute taxable gain on the sale of a residence and explain the requirements for excluding gain on the sale.**

**LO 3** **Determine the amount of allowable interest expense deductions on loans secured by a residence.**

**LO 4** **Discuss deductibility of real property taxes.**

**LO 5** **Explain the tax issues and consequences associated with rental use of the home, including determining the deductibility of residential rental real estate losses.**

**LO 6** **Describe the requirements necessary to qualify for home office deductions and compute the deduction limitations on home office deductions.**

**1.** Sue rents her vacation home for 60 days and lives there 30 days.
She had these income and expenses for the year.

| Total Income and Expenses | Total | | | | | | |
|---|---|---|---|---|---|---|---|
| Sue's gross rental income (60 days) | $6,000 | | | | | | |
| Real estate taxes | $3,650 | | | | | | |
| Mortgage interest expense | $7,300 | | | | | | |
| Utilities & maintenance expense | $6,000 | | | | | | |
| Depreciation | $9,000 | | | | | | |
| | | | | | | | |

How much depreciation can be deducted on her tax return, using any approved methods most favorable for the taxpayer?

**a.** $2,600 **b.** $2,200 **c.** $1,871 **d.** $1,600 **e.** $200

**2.** Jan and John purchased a new residence on **April 30, 2017.** Jan and John paid the full amount of the 2017 property taxes of $7,200 on their new house when the taxes became due in December of 2017. Property taxes for a calendar year are due at the end of the year in December. What amount of the taxes that Jan and John paid in December 2017 will they deduct on their 2017 federal income tax return?

**a.** Zero **b.** $2,400 **c.** $4,800 **d.** $7,200 **e.** Other

**3.** Serena is single. She purchased her principal residence three years ago. She lived in the home until she sold it at a $300,000 gain this year. Serena was allowed to exclude $250,000 of the $300,000 gain. What is the character of the $50,000 gain she was not able to exclude?

**a.** Ordinary income/gain **c.** Long-term capital gain
**b.** Short-term capital gain **d.** Personal gain

**4.** Which of the following statements regarding a taxpayer's principal residence is **true** for purposes of determining whether the taxpayer is eligible to exclude gain realized on the sale of the residence?

**a.** A taxpayer may have more than one principal residence at any one time.
**b.** A houseboat cannot be a taxpayer's principal residence.
**c.** A taxpayer with more than one residence may annually elect which residence is considered to be the principal residence.
**d.** None of the above statements is true

**5.** Which statement regarding the exclusion of gain on the sale of a principal residence is **correct**?

- **a.** A taxpayer may not exclude gain if the taxpayer is renting the residence at the time of the sale.
- **b.** A taxpayer may simultaneously own two homes that are eligible for the home sale exclusion.
- **c.** A taxpayer must be living in a residence at the time it is sold to qualify for the exclusion.
- **d.** For a married couple to qualify for the $500,000 exclusion, both spouses must meet the ownership and use tests.

**6.** Larry owned and lived in a home for five years before marrying Darlene. Larry and Darlene lived in the home for one year before selling it at a $600,000 gain. Larry was the sole owner of the residence until it was sold. How much of the gain may Larry and Darlene exclude?

**a.** $0 **b.** $250,000 **c.** $500,000 **d.** $600,000 **e.** Other

**7.** Shantel owned and lived in a home for five years before marrying Daron. Shantel and Daron lived in the home for two years before selling it at a $700,000 gain. Shantel was the sole owner of the residence until it was sold. How much of the gain may Shantel and Daron exclude?

**a.** $0 **b.** $250,000 **c.** $500,000 **d.** $700,000 **e.** Other

**8.** On November 1, 2016, Jamie (who is single) purchased and moved into her principal residence. In January, 2017, Jamie was laid off from her job. On February 1, 2017, Jamie sold the home at a $35,000 gain. She sold the home because she found a new job in a different state.
How much of the gain, if any, may Jamie exclude from her gross income in 2017?

**a.** $0 **b.** $3,125 **c.** $31,250 **d.** $35,000 **e.** Other

**9.** Dawn (single) purchased her home on June 1, 2003. On June 1, 2016, Dawn moved out of the home. She rented out the home until July 1, 2017 when she sold the home and realized a $230,000 gain (assume none of the gain was attributable to depreciation).
What amount of the gain will Dawn exclude from her 2017 gross income?

**a.** $0 **b.** $207,000 **c.** $225,000 **d.** $230,000 **e.** Other

**10.** Ethan (single) purchased his home on July 1, 2006. On July 1, 2014, he moved out of the home. He rented the home until July 1, 2016 when he moved back into the home.
On July 1, 2017 he sold the home and realized a $210,000 gain.
What amount of the gain is Ethan allowed to exclude from his 2017 gross income?

**a.** $0 **b.** $168,000 **c.** $200,000 **d.** $210,000 **e.** Other

**11.** What is the maximum amount of gain on the sale of principal residence a married couple may exclude from gross income?

**a.** $0 **b.** $25,000 **c.** $250,000 **d.** $500,000 **e.** Other

**12.** Which of the following best describes a qualified residence for purposes of determining a taxpayer's deductible home mortgage interest expense?

- **a.** Only the taxpayer's principal residence.
- **b.** The taxpayer's principal residence and two other residences (chosen by the taxpayer).
- **c.** The taxpayer's principal residence and one other residence (chosen by the taxpayer).
- **d.** Any two residences chosen by the taxpayer.

**13.** Which of the following statements regarding interest expense on home-related debt is correct?

- **a.** Taxpayers may deduct interest expense on a limited amount of home equity indebtedness but they may deduct interest expense on an unlimited amount of home acquisition indebtedness.
- **b.** Taxpayers may deduct interest expense on a limited amount of acquisition indebtedness but an unlimited amount of home equity indebtedness.
- **c.** Taxpayers may deduct interest expense on a limited amount of acquisition indebtedness and a limited amount of home equity indebtedness.
- **d.** None of the above statements is correct.

**14.** Patrick purchased a home on January 1, 2017 for $600,000 by making a down payment of $100,000 and financing the remaining $500,000 with a 30-year loan, secured by the residence, at 6 percent. During 2017 Patrick made interest-only payments on the loan of $30,000. On July 1, 2017, when his home was worth $600,000 Patrick borrowed an additional $75,000 secured by the home at an interest rate of 8 percent. During 2017, he made interest-only payments on this loan in the amount of $3,000. What amount of the $33,000 interest expense Patrick paid during 2017 may he deduct as an itemized deduction?

**a.** $0 **b.** $3,000 **c.** $30,000 **d.** $33,000 **e.** Other

**15.** Patricia purchased a home on January 1, 2017 for $1,200,000 by making a down payment of $100,000 and financing the remaining $1,100,000 with a 30-year loan, secured by the residence, at 6 percent. During 2017, Patricia made interest-only payments on the loan of $66,000. What amount of the $66,000 interest expense Patricia paid during 2017 may she deduct as an itemized deduction?

**a.** $0 **b.** $6,000 **c.** $60,000 **d.** $66,000 **e.** Other

**16.** Lauren purchased a home on January 1, 2016 for $500,000 by making a down payment of $200,000 and financing the remaining $300,000 with a 30-year loan, secured by the residence. During 2016, Lauren made interest-only payments on the loan. On July 1, 2016, when her home was valued at $500,000, she borrowed an additional $150,000, secured by the residence. During 2016, she made interest-only payments on the second loan. Which of the following statements regarding the deductibility of the interest Lauren paid is correct (assume she uses the chronological order of the loans to determine deductible interest expense if a limitation applies)?

- **a.** Lauren may deduct all of the interest on the first loan but she may deduct only two-thirds of the interest on the second loan unless she uses the loan proceeds to substantially improve the home.
- **b.** Lauren may deduct all of the interest on the first loan but she may deduct only two-thirds of the interest on the second loan no matter what she does with the proceeds of the second loan.
- **c.** Lauren may deduct all of the interest on the first loan or all of the interest on the second loan.
- **d.** Lauren may deduct all of the interest on the first loan and all of the interest on the second loan no matter what she does with the loan proceeds.

**17.** Kimberly purchased a home on January 1, 2016 for $500,000 by making a down payment of $200,000 and financing the remaining $300,000 with a 30-year loan, secured by the residence, at 6 percent. During 2016 and 2017 Kimberly made interest-only payments on the loan in the amount of $18,000 each year. On July 1, 2016, when her home was worth $500,000, Kimberly borrowed an additional $125,000 secured by the home at an interest rate of 8 percent. During 2016, she made interest-only payments on this loan in the amount of $2,500 and during 2017, she made interest only payments on the loan in the amount of $5,000. What is the maximum amount of the $23,000 interest expense Kimberly paid during 2017 that she may deduct as an itemized deduction, if she used the proceeds of the second loan to pay off student loans from law school?

**a.** $0 **b.** $5,000 **c.** $18,000 **d.** $21,647 **e.** $22,000 ☐

**18.** Jessica purchased a home on January 1, 2016 for $500,000 by making a down payment of $200,000 and financing the remaining $300,000 with a 30-year loan, secured by the residence, at 6 percent. During 2016 and 2017, Jessica made interest-only payments on the loan of $18,000 (each year). On July 1, 2016, when her home was worth $500,000 Jessica borrowed an additional $125,000 secured by the home at an interest rate of 8 percent. During 2016, she made interest-only payments on this loan in the amount of $5,000. During 2017, she made interest only payments in the amount of $10,000. What is the maximum amount of the $28,000 interest expense Jessica paid during 2017 that she may deduct as an itemized deduction if she used the proceeds of the second loan to finish the basement in her home, landscape the yard, and add a home theater room in the basement of the home?

**a.** $0 **b.** $10,000 **c.** $26,353 **d.** $26,000 **e.** $28,000 ☐

**19.** Two years ago, Jaspreet purchased a new home for $500,000 by making a down payment of $400,000 and financing the remaining $100,000 with a loan, secured by the residence, at 6 percent. In 2017, Jaspreet made interest only payments of $6,000 on the $100,000 loan. On January 1, 2017, when his home was valued at $500,000 Jaspreet executed two home equity loans (both secured by the home). The first was for $80,000 at an interest rate of 9 percent. The second home equity loan from a different bank was for $40,000 at an interest rate of 7 percent. In 2017, Jaspreet paid $7,200 of interest payments on the first home equity loan and $2,800 interest expense on the second. Jaspreet used the proceeds from the home-equity loans for purposes unrelated to the home. What is the maximum amount of interest expense Jaspreet can deduct on these loans as home related interest expense?

**a.** $6,000 **b.** $14,545 **c.** $14,600 **d.** $16,000 **e.** Other ☐

**20.** Three years ago, Kris purchased a new home for $200,000 by making a down payment of $150,000 and financing the remaining $50,000 with a loan, secured by the residence, at 6 percent. As of January 1, 2016, the outstanding balance on the loan was $40,000. On January 1, 2016, when his home was worth $300,000, Kris refinanced the home by taking out a $150,000 mortgage at 5 percent. With the loan proceeds, he paid off the $40,000 balance of the existing mortgage and used the remainder for purposes unrelated to the home. During 2016, he made interest only payments on the new loan of $7,500. What amount of the $7,500 interest expense on the new loan can Kris deduct in 2016 on the new mortgage as home related interest expense?

**a.** $2,000 **b.** $5,000 **c.** $7,000 **d.** $7,500 **e.** Other ☐

**21.** Amanda purchased a home for $1,000,000 in 2001. She paid $200,000 cash and borrowed the remaining $800,000. This is Amanda's only residence. In 2017, when the home had appreciated to $1,500,000 and the remaining mortgage was $600,000, interest rates declined and Amanda refinanced her home.
She borrowed $1,000,000 at the time of the refinancing.
She used the extra $400,000 for travel and jewelry.
What is her total amount of qualifying home-related debt for tax purposes?

**a.** $600,000 **b.** $700,000 **c.** $1,000,000 **d.** $1,100,000 **e.** Other

**22.** On March 31, 2016, Mary borrowed $200,000 to buy her principal residence.
Mary paid 3 points to reduce her interest rate from 6 percent to 5 percent.
The loan is for a 30-year period. What is Mary's 2016 deduction for her points paid?

**a.** $50 **b.** $150 **c.** $4,500 **d.** $6,000 **e.** Other

**23.** Which of these statements about the tax deductibility of points related to a home mortgage is correct?

**a.** Points paid in the form of a loan origination fee on an original home loan are deductible over the life of the loan.
**b.** Points paid in the form of prepaid interest on an original home loan are deductible over the life of the loan.
**c.** Points paid in the form of prepaid interest on a refinance are deductible over the life of the loan.
**d.** None of the above statements is correct.

**24.** On March 31, 2017, Mary borrowed $200,000 to refinance the original mortgage on her principal residence. Mary paid 3 points to reduce her interest rate from 6 percent to 5 percent.
The loan is for a 30-year period. How much can Mary deduct in 2017 for her points paid?

**a.** $200 **b.** $150 **c.** $4,500 **d.** $6,000 **e.** Other

**25.** Which of the following statements regarding deductions for real property taxes is incorrect?

**a.** A taxpayer is not allowed to deduct property taxes as the taxpayer makes monthly mortgage payments to an escrow account held by her mortgage company.
**b.** Taxpayers are not allowed to deduct payments made for setting up water and sewer services.
**c.** An individual deducts real property taxes on her principal residence as a for AGI deduction.
**d.** Taxpayers are not allowed to deduct payments made for neighborhood sidewalks.

**26.** Which of the following statements best describes the deductibility of real property taxes when a taxpayer sells real property during a year?

**a.** The owner of the property at the time the property taxes are due is responsible for paying all of the real property taxes on the property for the year. Consequently, this person is allowed to deduct all of the property taxes for the year.
**b.** Taxpayers are allowed to deduct the real property taxes they actually pay for the year.
**c.** Taxpayers are allowed to deduct the property taxes allocated to the portion of the year that they owned the property

**27.** On July 1 of 2015, Elaine purchased a new home for $400,000. At the time of the purchase, it was estimated that the property tax bill on the home for the year would be $8,000 ($400,000 × 2%). On the settlement statement, Elaine was charged $4,000 for the year in property taxes and the seller was charged $4,000. On December 31, Elaine discovered that the real property taxes on the home for the year were actually $9,000. Elaine wrote a $9,000 check to the local government to pay the taxes for that calendar year (Elaine was liable for the taxes because she owned the property when they became due). What amount of real property taxes may Elaine deduct for 2015?

**a.** $0 **b.** $4,000 **c.** $4,500 **d.** $5,000 **e.** $9,000 ☐

**28.** Which of the following statements regarding personal and/or rental use of a home is false? ☐

- **a.** A day for which a taxpayer rents a home to an unrelated party for less than the property's fair market value is considered to be a personal use day.
- **b.** A day for which a taxpayer rents a home to a relative for full fair market value is considered to be a rental use day.
- **c.** A day for which an unrelated non-owner stays in the home under a vacation exchange arrangement is considered to be a personal use day.
- **d.** A day for which the home is available for rent but is not occupied does not count as a personal use or a rental use day.

**29.** Kenneth lived in his home for the entire year except for when he rented his home (near a very nice ski resort) to a married couple for 14 days in December. The couple paid Kenneth $14,000 in rent for the two weeks. Kenneth incurred $1,000 in expenses relating to the home for the 14 days. Which of the following statements accurately describes the manner in which Kenneth should report his rental receipts and expenses for tax purposes? ☐

- **a.** Kenneth would include the rental receipts in gross income and deduct the rental expenses for AGI.
- **b.** Kenneth would exclude the rental receipts from gross income and deduct the rental expenses for AGI.
- **c.** Kenneth would include the rental receipts in gross income and would not deduct the rental expenses because he used the residence for personal purposes for most of the year.
- **d.** Kenneth would exclude the rental receipts, and he would not deduct the rental expenses.

**30.** Katy owns a second home. During 2017, she used the home for 20 personal use days and 50 rental days. Katy allocates expenses associated with the home between rental use and personal use. Katy did not incur any expenses to obtain tenants. Which of the following statements is correct regarding the tax treatment of Katy's income and expenses from the home? ☐

- **a.** Katy includes the rental receipts in gross income and deducts the expenses allocated to the rental use of the home for AGI.
- **b.** Katy deducts from AGI interest expense and property taxes associated with the home not allocated to the rental use of the home.
- **c.** Assuming Katy's rental receipts exceed the interest expense and property taxes allocated to the rental use, Katy's deductible expenses for 2017 may not exceed the amount of her rental receipts (she may not report a loss from the rental property).
- **d.** All of the above statements are correct.

**31.** Which of the following statements regarding the IRS and/or Tax Court approaches to allocating home-related expenses between rental use and personal use is correct?

- **a.** The Tax Court approach allocates more property tax and interest expense to rental use than does the IRS approach.
- **b.** The Tax Court and the IRS approaches allocate the same amount of expenses other than interest expense and property taxes to rental use.
- **c.** The IRS approach allocates interest expense and property taxes to rental use based on the ratio of the number of days of rental use to the total days of the year.
- **d.** None of the above statements is correct.

**32.** Brady owns a second home that he rents to others. During the year, he used the second home for 50 days for personal use and for 100 days for rental use. Brady collected $20,000 of rental receipts during the year. Brady allocated $7,000 of interest expense and property taxes, $10,000 of other expenses, and $4,000 of depreciation expense to the rental use. What is Brady's net income from the property and what type and amount of expenses will he carry forward to next year, if any?

- **a.** $0 net income. $1,000 depreciation expense carried forward to next year.
- **b.** ($1,000) net loss. $0 expenses carried over to next year.
- **c.** $0 net income. $1,000 of other expense carried over to next year.
- **d.** $0 net income. $1,000 of interest expense and property taxes carried over to next year

**33.** Harriet owns a second home that she rents to others. During the year, she used the second home for 10 personal days and for 200 rental days. Which of the following statements regarding the manner in which she should account for her income and/or expenses associated with the home is *incorrect*?

- **a.** Harriet's deductible expenses are not limited to the amount of gross rental income from the property.
- **b.** Harriet will be allowed to deduct all of the mortgage interest on the loan secured by the property.
- **c.** Harriet is required to include all of the rental receipts in gross income.
- **d.** Harriet is required to allocate all expenses associated with the home to rental use or personal use.

**34.** For a home to be considered a rental (nonresidence) property, a taxpayer must

- **a.** Rent the property for 15 days or more during the year.
- **b.** Use the property for personal purposes for no more than the greater of (a) 14 days or (b) 10 percent of the total days rented.
- **c.** Use the property for personal purposes for no more than the lesser of (a) 14 days or (b) 10 percent of the total days rented.
- **d.** A and B

**35.** When a taxpayer experiences a net loss from a nonresidence (rental property)

- **a.** The taxpayer will not be allowed to deduct the loss under any circumstance if the taxpayer does not have passive income from other sources.
- **b.** The loss is fully deductible against the taxpayer's ordinary income no matter the circumstances.
- **c.** If the taxpayer is *not* an active participant in the rental, the taxpayer may be allowed to deduct the loss even if the taxpayer does not have any sources of passive income.
- **d.** If the taxpayer is not allowed to deduct the loss due to the passive activity limitations, the

loss is suspended and carried forward until the taxpayer generates passive income or until the taxpayer sells the property.

**36.** Harvey rents his second home. During 2017, Harvey reported a net loss of $35,000 from the rental. If Harvey is an active participant in the rental and his AGI is $80,000, how much of the loss can he deduct against ordinary income for 2017?

**a.** $35,000 **b.** $25,000 **c.** $5,000 **d.** $0 **e.** Other

**37.** Irene rents her second home. During 2017, Irene reported a net loss of $15,000 from the rental. Irene is an active participant in the rental and her AGI is $140,000.
How much of the loss can she deduct against ordinary income in 2017?

**a.** $15,000 **b.** $10,000 **c.** $5,000 **d.** $0 **e.** Other

**38.** Jamison is self-employed and he works out of an office in his home. After allocating the home-related expenses between the business office and the rest of the home, which of the following statements regarding the sequence of deductibility of the expenses allocated to the home office business use is correct?

**a.** Depreciation expense, other expenses, property taxes and interest expense
**b.** Other expenses, depreciation expense, property taxes and interest expense
**c.** Property taxes and interest expense, depreciation expense, other expenses
**d.** Other expenses, property taxes and interest expense, depreciation expense
**e.** None of the above statements is correct.

**39.** Which of the following statements regarding limitations on the deductibility of home office expenses of employees is correct?

**a.** Deductible home office expenses of employees are miscellaneous itemized deductions subject to the 2 percent of AGI floor.
**b.** Deductible home office expenses of employees are miscellaneous itemized deductions not subject to the 2 percent floor.
**c.** Deductible home office expenses of employees are for AGI deductions limited to gross income from the business.
**d.** Deductible home office expenses of employees are for AGI deductions not limited to gross income from the business.

**40.** Which of the following statements regarding the home office expense deduction is correct?

**a.** Taxpayers allocate expenses of the home to the home office based on the size of the office relative to the size of the home.
**b.** A taxpayer is not allowed to deduct any home office expenses unless the taxpayer has no other place to do business.
**c.** A taxpayer is not allowed to deduct any depreciation associated with a home as a home office expense.
**d.** A taxpayer must own a home in order to claim home office expenses.