

## Basis

Without, a Taxpayer has  
Nothing!

---

---

---

---

---

---

---

---

## TxSEA

➤ This presentation is made courtesy of  
The Texas Society of Enrolled Agents  
[www.TxSEA.org](http://www.TxSEA.org)  
Material is covered by copyright law and is  
used with the permission of the author.

---

---

---

---

---

---

---

---

## Capital Assets

- Stocks and bonds
- Principal residences
- Secondary residences (not used as rental)
- Household furnishings
- Automobiles – personal
- Coin collections
- Gems or jewelry

Page 2

---

---

---

---

---

---

---

---

## Excluded

- 5 type of property excluded
- Not included in definition of Capital Asset
- 1. Stock in trade or other inventory, and property held for sale to customers in ordinary course of business

Page 2

---

---

---

---

---

---

---

---

## Example

- Real Estate Developer
- Subdivides property and sells lots
- If lots held more than one year – can capital gains rate be used?
- NO – part of stock and trade

Page 2

---

---

---

---

---

---

---

---

## A/R or Notes Receivable

- Ordinary course of trade or business
- For services rendered
- Or from sale of such assets
- Not capital assets

Page 2

---

---

---

---

---

---

---

---

## Example

- Real Estate Developer
- Sells a lot by taking back a note against property
- Note held more than 1 year and sells note to another for a "profit"
- No Capital Gain as note was acquired in ordinary course of developer's trade or business

Page 2

---

---

---

---

---

---

---

---

## Depreciable Personal and Real Property Used in Trade/Business

- *Practitioner's Alert: Rental property is a type of investment but is considered "trade or business" property and would not be considered a capital asset.*

*It is possible to receive long-term capital gain rates on the economic gain on the sale, however depreciation recovered will NOT be treated as Capital Gain income.*

Page 3

---

---

---

---

---

---

---

---

## Example

- 2001 purchased rental property for \$50,000
- \$9,000 total depreciation claimed
- Property sells in 2010 for \$55,000
- Gain is \$14,000 – First \$9,000 recaptured
- \$5,000 capital gains

Page 3

---

---

---

---

---

---

---

---

Tax Professional's Alert

*Rules get very complicated for personal property used in a trade or business:  
Auto, furniture and fixtures, computers.*

*Special rules regarding the computation for the gain on the sale of these assets apply.*

Page 3

---

---

---

---

---

---

---

---

Copyright, Literary, Musical or Artistic Comp., Letter or Memo

➤ If:

- Created by your personal efforts,
- Letters, memorandums, or similar property prepared or produced for you
- Acquired from a person who created the property – by gift

Page 3

---

---

---

---

---

---

---

---

Tax Professional's Alert

*You write the Great American Novel and hold on to the manuscript for more than a year, then sell it.*

*No long-term capital gain because YOU are the creator.*

*The novel is not a capital asset in your hands*

Page 3

---

---

---

---

---

---

---

---

### U. S. Gov't Publications

- Received for free or for less than normal sales price.
- Not normally a BIG income producer.

Pages 3 & 4

---

---

---

---

---

---

---

---

### Taxation

- Type of asset sold determines rules
- Held more than one year
- Preferred tax treatment

Page 4

---

---

---

---

---

---

---

---

### Such Assets

- Coin or stamp collections
- Jewelry and art
- Stocks and Bonds
- Home, if gain is not all excluded
- Household furnishings

Page 4

---

---

---

---

---

---

---

---

## Capital Gains Rates

- Rates on Page 4 & 5 of text material
- Ranges from ZERO% to 28%
- Holding Periods:  
Short-Term  
Long-Term

Page 4

---

---

---

---

---

---

---

---

## 2010 Tax Act

- Extension of ZERO rate for 2011 and 2012
- Net short-term capital gain – no special rate
- 25% unrecaptured Section 1250 gain  
Disposition of depreciable real estate

Pge 5

---

---

---

---

---

---

---

---

## Tax Professional's Alert

- 2010 Tax Relief Act gives temporary exclusion of 100% of gain on certain small business stock
- Through December 31, 2011

Pge 5

---

---

---

---

---

---

---

---

## General Holding Period Rule

- Long-term – 1 year and 1 day holding period
- Acquisition date is not in holding period
- Stock purchased 1/4/09 holding period begins 1/5/09 and long-term gain at sale on 1/5/2010

Page 6

---

---

---

---

---

---

---

---

## Caution

- Taxpayers here they must hold stock 1 year for capital gains
- If this stock bought on 1/4/09 is sold on 1/4/10, the capital gain is short-term

Page 6

---

---

---

---

---

---

---

---

## Twist

- Stock bought last day of month, regardless of number of days in the month
- Long-term capital gain if sold 1<sup>st</sup> day of 13<sup>th</sup> month after purchase
- Stock bought 4/30/09 sold 5/1/10 – gain is long-term

Page 6

---

---

---

---

---

---

---

---

### Special Holding Periods

- Inherited assets
- ISO's – incentive stock options
- Qualified Small Business Stock
- Commodity Futures
- Capital Gain from mutual fund
- Gifts
- Property acquired in a divorce

Page 7

---

---

---

---

---

---

---

---

### More Special Assets

- Deferred gain on property exchanged for other property
- Example: You swap an apartment building for an office building, holding period for the office building includes the holding period of time you held the apartment building.

Page 7

---

---

---

---

---

---

---

---

### However....

- Assets, such as stocks or bonds owned by an IRA – Individual Retirement Account or a qualified retirement plan (401k)
- Do NOT qualify for long-term capital gain
- All withdrawals are ordinary income

Pge 7

---

---

---

---

---

---

---

---

### Calculating Basis

- Tax system's measurement of what your paid
- Used in calculation of:  
Capital Gains and Losses  
Deductions for Depreciation, Casualty Losses and Charitable Gifts

Page 7

---

---

---

---

---

---

---

---

### Basis on Acquisition

- 3 Basic types
  - A. Cost basis
  - B. Fair Market Value basis
  - C. Transferred basis

Page 7

---

---

---

---

---

---

---

---

### Example

- 100 shares purchased of SBC Fund at \$40 per share = Cost of \$4,000
- Dividend is paid of \$2/sh – \$200
- Dividend is reinvested in additional stock
- Cost of share is \$50, receiving 4 shares

Page 8

---

---

---

---

---

---

---

---

### Example continues

- Now you own 104 shares
- At \$50/sh total value is \$5,200
- Your basis is \$4,000, original investment plus \$200 from taxable dividend reinvested = \$4,200
- All shares sold for \$5,200
- Profit \$1,000 (\$5,200 less basis of \$4,200)

Page 8

---

---

---

---

---

---

---

---

### Code Sections Used to Determine Basis

- 1014 – Inherited
- 1041 – Divorce
- 1031 – Like-Kind Exchange
- S Corporation – Shareholder
- 1060 – Sale of business – Form 8594
- Partnership – Partner  
Inside Basis  
Outside Basis

Page 9

---

---

---

---

---

---

---

---

### Tax Professional's Alert

- Shareholders in S Corporations as well as Partners in Partnerships – basis will be determined by how interest was acquired, such as by gift or inheritance.

Page 9

---

---

---

---

---

---

---

---

### Property Received by GIFT

- Basis in property received as gift:
  1. Adjusted basis to the donor just before given
  2. FMV at the time it was given to you, and
  3. Any gift tax paid on the gift

Page 9

---

---

---

---

---

---

---

---

### Fair Market Value

- If FMV is less than donor's adjusted basis:
  1. Basis for gain is same as donor's adjusted basis, increased by gift tax paid, and
  2. Basis for a loss is its FMV at time received, increased by any gift tax paid

Page 9

---

---

---

---

---

---

---

---

### Example

- Father give you stock – his basis \$10,000
- Worth only \$8,000 when he gives it to you
- You sell stock for \$12,000
- Gain is \$2,000 ( $\$12,000 - \$10,000$ )

Page 9

---

---

---

---

---

---

---

---

### Example continued

- Stock sells for \$7,000
- Your loss is \$1,000 ( $\$7,000 - \$8,000$ )
- Gift tax paid is added to your basis
- The donor cannot gift a "loss"

Page 9

---

---

---

---

---

---

---

---

### Example

- Father gives you a gift of stock with basis of \$5,000 and worth \$12,000 when given.
- Basis for figuring gain or loss is \$5,000

Page 10

---

---

---

---

---

---

---

---

### Section 83 – FMV of Services Rendered

- You put the "deal" together and receive 100 shares of stock valued at \$10,000
- You pay tax on the \$10,000 and your basis in the 100 shares is \$10,000
- Amount included in income is basis

Page 10

---

---

---

---

---

---

---

---

## Definitions

- Property to IRS is anything you OWN
- More than just homestead or real estate
- Original Basis = investment in property
- Used for depreciation, amortization, depletion, casualty losses and gain or loss on sale

Page 10

---

---

---

---

---

---

---

---

## Cost Includes

- Sales tax
- Other expenses connected with the purchase

Page 10

---

---

---

---

---

---

---

---

## Adjusted Basis

- |                                |  |
|--------------------------------|--|
| ➤ Increased by:                | ➤ Decreased by:  |
| ➤ Improvements to the property | ➤ Depreciation   |
|                                | ➤ Insurance reimbursements for casualty and theft losses |
|                                | ➤ Credits against cost                                   |

Page 11

---

---

---

---

---

---

---

---

### Tax Professional's Alert

➤ You must know adjusted basis if you:

- Sell
- Trade
- Dispose of asset OR
- Suffer a Casualty Loss

Page 11

---

---

---

---

---

---

---

---

### Records

➤ Records for these assets should be retained until the asset is disposed of and at least 3 years after the tax return reports the disposition.

Page 11

---

---

---

---

---

---

---

---

### Tax Basis

➤ Original cost paid for an investment

➤ Plus expenses

➤ Basis is used for reporting capital gains or losses on the property

Page 11

---

---

---

---

---

---

---

---

### Example

- Stock bought for \$1,000 two years ago
- Sold today for \$1,500
- Basis of \$1,000
- Taxable capital gain of \$500

Page 11

---

---

---

---

---

---

---

---

### Depreciation

- Property includes:
  - Buildings
- Machinery
  - Vehicles
- Equipment
  - Furniture

Page 11

---

---

---

---

---

---

---

---

### Depreciable Property Does NOT Include

- Personal property such as a personal automobile
- Used for both business and personal, only business use portion is depreciated

Page 11

---

---

---

---

---

---

---

---

### 3 Tests for Depreciable Property

- 1. Must be used in business or other income-producing activity
- 2. Must wear out, decay, gets used up, becomes obsolete or loses value from natural causes
- Must have a determined useful life beyond one year

Page 12

---

---

---

---

---

---

---

---

### Methods of Depreciation

- ACRS
- MACRS
- Pre-1981 Depreciation
- Section 179 Depreciation

Page 12

---

---

---

---

---

---

---

---

### Casual Loss Deductions

- When deductible Casualty Loss occurs:
  1. New basis in property is used for depreciation
  2. Tables can no longer be used to compute depreciation
  3. Actual formulas for depreciation are used

Page 12

---

---

---

---

---

---

---

---

## Records

- Capital Asset Records
- Accounting records including amount of accumulated depreciation claimed for assets over the years
- Deemed – Adjusted Basis

Page 12

---

---

---

---

---

---

---

---

## Tax Professional's Alert

- Records should be retained as long as you own the asset AND
- For a minimum of 3 years from the filing date of the tax return reporting the disposition of the asset

Page 12

---

---

---

---

---

---

---

---

## Depreciation Methods

- Rules and methods vary
- Use when first placed in service
- Rules in effect at placed in service date are used throughout life of asset

Page 12

---

---

---

---

---

---

---

---

### Keeping Records

- Keep track of business assets
- Original cost
- Depreciation claimed

Page 13

---

---

---

---

---

---

---

---

### Used to Calculate

- Taxable gain
- Deductible loss
- Break-even

Page 13

---

---

---

---

---

---

---

---

### Accumulated Depreciation

- Begins date of asset acquisition
- Depreciation over useful life of asset
- Cumulative depreciation to date

Page 13

---

---

---

---

---

---

---

---

### Tax Professional's Alert

- Record keeping will record accumulated depreciation in order to determine:

When asset is fully depreciated

No more depreciation can be claimed

Page 13

---

---

---

---

---

---

---

---

### MACRS

- If not using Code Section 179
- Category of asset, specifying time period over which depreciation takes place

Page 13

---

---

---

---

---

---

---

---

### Some Assets NOT Available for MACRS

- Patents
- Trademarks
- Business goodwill

Pages 13 & 14

---

---

---

---

---

---

---

---

## MACRS

- IRS provides table
- MACRS provides slightly higher write-off
- Basis does not change
- Only percentage used as multiplier changes

Page 14

---

---

---

---

---

---

---

---

## Asset NOT Used 100% for Business

- Multiply by percentage of business use  
#####
- Certain situations require:  
Assets of similar type to be grouped into general asset accounts

Variations on MACRS are available for slower depreciation

Page 14

---

---

---

---

---

---

---

---

## More Depreciation Info.

- Farm property and 15-20 year property must take slower depreciation
- SL depreciation also available – mandatory for AMT purposes
- Older methods of depreciation are for pre-1987 property

Page 14

---

---

---

---

---

---

---

---

### Disposing of Capital Assets

- Sale, scrap, or otherwise remove – reporting must be on the tax return
- Sale of Capital Assets:
  - Gains – Taxed at lower rate – Table Pages 4 & 5
  - Loss – Deducted, may be limited

Page 15

---

---

---

---

---

---

---

---

### Other Dispositions

- Trades of same asset class property – no recognition of gain or loss
- Instead, non-taxable like-kind exchange
- Example: Trade of an old vehicle for new one.

Page 15

---

---

---

---

---

---

---

---

### Calculation

- Disposing of a capital asset
- Gain or loss is computed by subtracting adjusted tax basis for the property from new proceeds of the sale

Page 15

---

---

---

---

---

---

---

---

### Proceeds From the Sale Include

- Cash received
- FMV of any property or services received
- Value of any existing mortgage, loans and other debts that are assumed by the buyer

Page 15

---

---

---

---

---

---

---

---

### Subtract Costs Incurred

- Broker's commissions
- Advertising expenses
- Appraisal fees
- Legal fees
- Surveys
- Abstract and recording fees
- Title insurance
- Transfer or stamp taxes

Pge 15

---

---

---

---

---

---

---

---

### Tax Professional's Alert

- Adjusted tax basis is generally original cost plus the cost of improvements or additions, minus any depreciation claimed or casualty losses deducted.

Page 15

---

---

---

---

---

---

---

---

## Working Knowledge Required

- Special Capital Gain Rates
- How to calculate
- How recapture rules limit capital gain rules
- Foreclosure and involuntary conversions
- Installment sale rules
- Stock of Qualified Small Business Corporations
- How to report sales of capital assets on a tax return

Page 16

---

---

---

---

---

---

---

---

## Tax Professional's Alert

- Workpapers maintained by the tax professional should always substantiate basis and the calculation method.

Page 16

---

---

---

---

---

---

---

---

## Thank You

- Your TIME is precious.
- We hope that the TIME spent today is beneficial to you and your tax practice.
- The Texas Society of Enrolled Agents is pleased to share this information with you.

---

---

---

---

---

---

---

---