

Key Terminology

Taxpayer Relief Act of 1997	reduced several federal taxes in the US
IRC Section 121	provides each taxpayer filing a federal tax return an exclusion on capital gains tax when selling their primary residence
capital gain	the difference b/w a lower selling and a higher purchase price, resulting in a financial loss to seller
realized gain	gain that is not necessarily taxed
recognized gain	amt of gain which is subject to tax when property is disposed of at a gain or profit in a taxable transfer
basis	a major accounting method that recognizes revenues and expenses at the time physical cash is actually received or paid out
boot	cash received in a tax-deferred exchange

Key Terminology (cont)

recaptured depreciation	when real property is sold at a gain and accelerated depreciation has been claimed, the owner may be required to pay a tax at ordinary (non-accelerated) rates to the extent of the excess accelerate depreciation
home equity financing	mortgage that uses qualified home as collateral
appreciation	monetary gain resulting from the increase in market value of an investment, excluding additions of capital
LIHC	established under the Tax Reform Act of 1986 to promote private sector involvement in the retention and production of rental houses for low income households

1031 Exchange

- 1.) sale of property
- 2.) 45 days to identify new property
- 3.) 180 days to acquire/close on property

Major benefit is that an owner can delay the payment of capital gains taxes, which provides him/her with extra capital to use in the present day

Depreciation

depreciation	a loss of utility and thus value caused by the physical deterioration, functional obsolescence or economic obsolescence or any combination thereof
straight-line depreciation	a method of calculating the depreciation of an asset which assumes the asset will lose an equal amount of value each year
tax depreciation	an income deduction that allows a taxpayer to recover the cost or basis of certain property' it is an annual allowance for the wear and tear, deterioration, or obsolescence of the property
Non-depreciable assets:	personal use assets; land
Depreciable assets:	buildings; equipment; machinery
component depreciation	difference b/w a lower selling price and a higher purchase price, resulting in a financial loss to the seller

Investors can benefit from depreciation when they own the property but may be a liability when they sell the property

residential property is depreciated over 27.5 yrs
commercial property is depreciated over 39 yrs



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Income Types

Operations Income	active income	salaries, business participation
	portfolio income	dividends, interest annuities, royalties
	passive income (invested funds)	earnings an individual derives from a rental property in which he/she is not actively involved
Capital Gain	short term	asset is held < 12 months
	long term	asset is held > 12 months w/ tax rate approx. 23.5%

Tax exemption applies every 2 yrs provided:

- property is primary residence
- taxpayer has lived in home for at least 2 out of the past 5 yrs

Missed/Unsure Questions

What type of depreciation is described by the physical deterioration of property?

economic depreciation

When calculating the amount of taxes to be paid on a property, the tax rate is multiplied by what number?

taxable income

When depreciation is subtracted from net income to determine a property's taxable income, what is the depreciation considered?

tax deduction

Using the straight-line depreciation method, commercial property is depreciated over how many years?

39 yrs

Missed/Unsure Questions (cont)

When executing a 1031 exchange, what does the tax code require an owner to purchase?

like-kind properties



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