

[LO 1] Rafael sold an asset to Jamal. What is Rafael's amount realized on the sale in each of the following alternative scenarios?

- Rafael received \$80,000 of cash and a vehicle worth \$10,000. Rafael also paid \$5,000 in selling expenses.
- Rafael received \$80,000 of cash and was relieved of a \$30,000 mortgage on the asset he sold to Jamal. Rafael also paid a commission of \$5,000 on the transaction.
- Rafael received \$20,000 of cash, a parcel of land worth \$50,000, and marketable securities of \$10,000. Rafael also paid a commission of \$8,000 on the transaction.

a. \$85,000, computed as follows:

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Cash received	\$80,000	Given
(2) Vehicle received	10,000	Given
(3) Selling expenses	(5,000)	Given
<b>Amount Realized</b>	<b>\$85,000</b>	<b>(1) + (2) + (3)</b>

b. \$105,000, computed as follows:

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Cash received	\$80,000	
(2) Relief of debt	30,000	
(3) Commissions	(5,000)	
<b>Amount Realized</b>	<b>\$105,000</b>	<b>(1) + (2) + (3)</b>

c. \$72,000, computed as follows:

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Cash received	\$20,000	
(2) Land	50,000	
(3) Marketable securities	10,000	
(4) Commissions	(8,000)	
<b>Amount Realized</b>	<b>\$72,000</b>	<b>(1) + (2) + (3) + (4)</b>

[LO 3, 4] In year 0, Longworth Partnership purchased a machine for \$40,000 to use in its business. In year 3, Longworth sold the machine for \$35,000. Between the date of the purchase and the date of the sale, Longworth depreciated the machine by \$22,000.

- What are the amount and character of the gain or loss Longworth will recognize on the sale?
- What are the amount and character of the gain or loss Longworth will recognize on the sale if the sale proceeds are increased to \$45,000?
- What are the amount and character of the gain or loss Longworth will recognize on the sale if the sale proceeds are decreased to \$15,000?

a. \$17,000 ordinary income.

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Amount Realized	\$35,000	Given
(2) Initial Basis	40,000	Given
(3) Accumulated Depreciation	<u>22,000</u>	Given
(4) Adjusted Basis	18,000	(2) - (3)
(5) Gain/(Loss) Recognized	\$17,000	(1) - (4)
(6) Ordinary income (§1245 depreciation recapture)	\$17,000	Lesser of (3) or (5)
<b>§1231 gain</b>	<b>\$0</b>	(5) - (6)

Because the entire gain is caused by depreciation deductions, the entire gain is treated as ordinary income under §1245.

b. \$27,000 gain (\$22,000 ordinary and \$5,000 §1231) computed as follows:

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Amount Realized	\$45,000	Given
(2) Initial Basis	40,000	Given
(3) Accumulated Depreciation	<u>22,000</u>	Given
(4) Adjusted Basis	18,000	(2) - (3)
(5) Gain/(Loss) Recognized	\$27,000	(1) - (4)
(6) Ordinary income (§1245 depreciation recapture)	\$22,000	Lesser of (3) or (5)
<b>§1231 gain</b>	<b>\$5,000</b>	(5) - (6)

Only the gain caused by depreciation is treated as ordinary income under §1245, the remaining gain is §1231.

c. (\$3,000) §1231 loss, computed as follows:

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Amount Realized	\$15,000	Given
(2) Initial Basis	40,000	Given
(3) Accumulated Depreciation	<u>22,000</u>	Given
(4) Adjusted Basis	18,000	(2) - (3)
(5) Gain/(Loss) Recognized	(\$3,000)	(1) - (4)
(6) Ordinary income (§1245 depreciation recapture)	\$0	
<b>§1231 loss</b>	<b>(\$3,000)</b>	(5) - (6)

Only gains are treated as ordinary income under §1245, any loss is §1231.

[LO 5] Bourne Guitars, a corporation, reported a \$157,000 net §1231 gain for year 6.

- Assuming Bourne reported \$50,000 of nonrecaptured net §1231 losses during years 1–5, what amount of Bourne’s net §1231 gain for year 6, if any, is treated as ordinary income?
- Assuming Bourne’s nonrecaptured net §1231 losses from years 1–5 were \$200,000, what amount of Bourne’s net §1231 gain for year 6, if any, is treated as ordinary income?

- a. \$50,000 of Bourne's gain would be ordinary income and the remaining \$107,000 gain is a §1231 gain, computed as follows:

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Current §1231 gain	\$157,000	Given
(2) Nonrecaptured §1231 losses	\$50,000	Given
(3) Ordinary income	\$50,000	Lesser of (1) or (2)
§1231 gain	\$107,000	(1) - (3)

- b. The entire \$157,000 gain would be ordinary income due to the §1231 look-back rule.

[LO 6] Kase, an individual, purchased some property in Potomac, Maryland, for \$150,000 approximately 10 years ago. Kase is approached by a real estate agent representing a client who would like to exchange a parcel of land in North Carolina for Kase's Maryland property. Kase agrees to the exchange. What is Kase's realized gain or loss, recognized gain or loss, and basis in the North Carolina property in each of the following alternative scenarios?

- a. The transaction qualifies as a like-kind exchange, and the fair market value of each property is \$675,000.  
 b. The transaction qualifies as a like-kind exchange, and the fair market value of each property is \$100,000.

- a. Even though Kase has a realized gain of \$525,000, the recognized gain is \$0 because the transaction qualifies as a like-kind exchange and Kase did not receive any boot. Kase receives a carryover basis of \$150,000 in the North Carolina property (the same basis Kase had in the Maryland property). See the following computation:

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Amount realized from property	\$675,000	Given
(2) Amount realized from boot (non like-kind property)	\$0	Given
(3) Total amount realized	\$675,000	(1) + (2)
(4) Adjusted basis	\$150,000	Given
(5) Gain realized	\$525,000	(3) - (4)
(6) Gain recognized	\$0	Lesser of (2) or (5)
(7) Deferred gain	\$525,000	(5) - (6)
<b>Adjusted basis in new property</b>	<b>\$150,000</b>	(1) - (7)

- b. Kase has a realized loss of (\$50,000), but the recognized loss is \$0 because the transaction qualifies as a like-kind exchange. Kase would have a carryover basis of \$150,000. See the following computation:

<b>Description</b>	<b>Amount</b>	<b>Explanation</b>
(1) Amount realized from property	\$100,000	Given
(2) Amount realized from boot (cash)	\$0	Given
(3) Total amount realized	\$100,000	(1) + (2)

<i>(4) Adjusted basis</i>	<u><i>\$150,000</i></u>	<i>Given</i>
<i>(5) Loss realized</i>	<i>(\$50,000)</i>	<i>(3) – (4)</i>
<i>(6) Loss recognized</i>	<i>\$0</i>	<i>Lesser of (2) or (5), limited to zero</i>
<i>(7) Deferred loss</i>	<i>(\$50,000)</i>	<i>(5) – (6)</i>
<b><i>Adjusted basis in new property</i></b>	<b><i>\$150,000</i></b>	<b><i>(1) – (7)</i></b>