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Defense Against The IRS, Tax Planning, Pension Planning, Business Planning

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December 1, 2007 **Volume 18, Number 5**

REPOSSESSION OF REAL ESTATE

With the impact of interest rate increases and cost of living increases, many people who financed the sale of real estate are now having to repossess for default on mortgages. This newsletter will outline the tax basics of repossession where the real estate previously sold that was *not* the seller's principal residence. The rules discussed below apply to the repossession of real estate held by the seller for investment or for use in his trade or business.

Gain recognition rules. You will have to report gain to the extent the amount of money and the value of other property you were paid by the buyer before the repossession is greater than the amount of gain you have already reported on the sale. (Unfortunately, however, if the amount you received is less than your previously reported gain, you cannot report a loss.)

Example. Ron sells real estate for \$100,000. His basis was \$20,000 (thus his gain on the sale was \$80,000). He was paid a \$10,000 down payment and was to receive nine more \$10,000 payments, under an installment note he took from the buyer. After the first two payments were made, however, the buyer defaulted and Ron repossessed the property. He had \$5,000 in expenses in connection with the repossession.

Ron was reporting his gain from the sale on the installment method. His gain percentage was 80% (sale price \$100,000; gain \$80,000), so he reported \$24,000 of gain on the \$30,000 in payments he received before default (the \$10,000 down payment plus the first two \$10,000 installment payments).

When the property is repossessed, Ron reports \$6,000 of gain: the excess of cash received before the repossession (\$30,000) over the amount of gain previously reported (\$24,000).

Note that the repossession expenses do not reduce the taxable gain on the repossession.

Gain limitation. Note that under a gain limitation rule, the gain to be reported on the repossession of real property can never exceed the original sale price minus (1) your original basis in the property, (2) the gain you recognized, and (3) your expenses of repossession. In the above example, this would be \$100,000 minus \$49,000 (\$20,000 + \$24,000 + \$5,000), which equals \$51,000. So in the example, Ron would report the \$6,000 gain without the limitation having an impact.

Basis of repossessed property. The basis of the repossessed property will be the basis you had in the debt, plus any gain you reported on the repossession, plus any expenses you incurred in connection with the repossession.

In the above example, Ron's basis in the outstanding debt of \$70,000 (\$90,000 – two \$10,000 payments) was \$14,000. This is because the gain portion of the debt was 80%, as noted above. Thus, the remainder (20% of \$70,000, or \$14,000) represents Ron's basis in the debt. So, Ron's basis in the repossessed property is \$25,000: \$14,000 + \$6,000 (gain recognized) + \$5,000 (expenses of repossession). Of course, Ron may have gain or loss if and when he resells the property.

STANDARD MILEAGE RATE FOR 2008

IRS has announced that the optional mileage allowance for owned or leased autos (including vans, pickups or panel trucks) is 50.5¢ for business travel after 2007. However, the rate for using a car to get medical care or in connection with a move that qualifies for the moving expense deduction is 19¢ per mile, down 1¢ from the 2007 allowance of 20¢ per mile. (Rev Proc. 2007-70)

Simplified deduction method. The mileage allowance deduction replaces separate deductions for lease payments (or depreciation if the car is purchased), maintenance, repairs, tires, gas, oil, insurance and license and registration fees. A taxpayer may, however, still claim separate deductions for parking fees and tolls connected to business driving.

The standard mileage rate may not be used for a purchased auto if:

- it was previously depreciated using a method other than straight-line for its estimated useful life;
- a [Code Sec. 179](#) expensing deduction was claimed for the auto;
- the taxpayer depreciated it using MACRS under; or
- the vehicle is used for hire, such as a taxicab.

Also, the standard mileage rate cannot be used to compute the deductible expenses of five or more autos owned or leased by a taxpayer and used simultaneously (such as in fleet operations).

Rural mail carriers who receive qualified reimbursements also cannot use the standard mileage.

A taxpayer who uses the mileage allowance method for an auto he owns may switch in a later year to deducting the business connected portion of actual expenses, so long as he depreciates it from that point on using straight line depreciation over the auto's remaining life.

A taxpayer may use the mileage allowance method for a leased auto only if he uses that method (or a fixed and variable rate (FAVR) allowance method) for the entire lease period (including renewals). If the lease period began before '98, this rule applies only for the post-'97 portion of the lease period (including renewals).

Other business mileage rate rules. For 2008, the depreciation component of the mileage rate is 21¢ per mile (19¢ per mile for 2007, 17¢ per mile for 2006 and 2005, 16¢ per mile for 2004 and 2003). The depreciation component reduces the basis of the auto for gain or loss purposes.



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