

On November 4, 2018, Blue Company Acquired An Asset (27.5-year Residential Real Property) For \$200,000

Introduction: Blue Company's Acquisition of Residential Real Property

On November 4, 2018, Blue Company acquired an asset (27.5-year residential real property) for \$200,000. This transaction marked a significant investment in the company's real estate portfolio, providing both strategic value and potential tax benefits. Understanding the nuances of this acquisition, including the asset's classification, depreciation methods, and financial implications, is essential for accurate accounting and maximizing tax deductions. This article explores the detailed aspects of this acquisition, offering insights into the accounting treatment, depreciation schedules, and related considerations.

Background of the Acquisition

Details of the Asset

- Type of Asset: Residential real property
- Lease Term: 27.5 years (common for residential real estate under IRS rules)
- Acquisition Date: November 4, 2018
- Purchase Price: \$200,000
- Purpose: Investment property for rental income or capital appreciation
- Location: [Insert location if known]

Significance of the 27.5-year Lease Term

The 27.5-year period aligns with the typical lifespan for residential real estate depreciation under IRS guidelines, which impacts how the property is depreciated over its useful life.

Accounting for the Acquisition

Initial Recognition

When Blue Company acquires a residential property, the initial journal entry typically records:

- The asset at its purchase price
- Any associated costs (e.g., closing costs, legal fees) that are capitalized
- Deduction of land value from the total purchase price if applicable

Example Journal Entry:

Account	Debit	Credit
Residential Property (Asset)	\$200,000	
Cash		\$200,000

Note: If part of the purchase price is allocated to land (which is not depreciable), the land value must be separated from the building value.

Allocation of Purchase Price between Land and Building

Since land cannot be depreciated, it's important to allocate the \$200,000 purchase price between land and the building. Typically, an appraisal or tax assessment provides the basis for this allocation.

Sample Allocation:

- Land: 20% of total value = \$40,000
- Building (Residential Property): 80% of total value = \$160,000

Adjusted Journal Entry:

Account	Debit	Credit
Land	\$40,000	
Building (Residential Property)	\$160,000	
Cash		\$200,000

Depreciation of Residential Real Property

Understanding Residential Real Property Depreciation

Under IRS rules, residential rental properties are depreciated over 27.5 years using the straight-line method. This means an equal amount of depreciation expense is recognized each year over the asset's useful life.

Annual Depreciation Calculation:

- Building value: \$160,000

- Depreciation period: 27.5 years
- Annual depreciation expense: $\$160,000 \div 27.5 \approx \$5,818.18$

Journal Entry for Annual Depreciation:

```plaintext

Debit: Depreciation Expense \$5,818.18

Credit: Accumulated Depreciation \$5,818.18

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Note: Land is not depreciable, so its value remains unaffected by depreciation.

First-Year Depreciation Calculation

Since the property was acquired late in the year (November 4, 2018), depreciation for the first year should be prorated.

Proration:

- Number of days in 2018: from November 4 to December 31 = 58 days
- Total days in 2018: 365
- Depreciation for 2018 = $(\$5,818.18 \times 58/365) \approx \923.63

First-year depreciation journal entry:

```plaintext

Debit: Depreciation Expense \$923.63

Credit: Accumulated Depreciation \$923.63

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Tax Considerations and Benefits

Section 179 and Bonus Depreciation

Although residential real estate is generally depreciated over 27.5 years, certain tax incentives might be applicable during initial years, such as bonus depreciation or Section 179 deductions for qualifying property improvements.

Impact on Taxable Income

Depreciation reduces taxable income, providing tax savings each year. Over time, accumulated depreciation can lead to a book basis lower than the original cost, affecting gains or losses upon sale.

Recapture of Depreciation

When the property is eventually sold, depreciation recapture may be required, which could lead to additional tax liabilities at the sale.

Long-Term Management and Record-Keeping

Maintaining Accurate Records

Proper documentation is vital for:

- Supporting depreciation deductions
- Calculating gain or loss upon sale
- Compliance with IRS regulations

Key documentation includes:

- Purchase agreement
- Allocation of purchase price
- Depreciation schedules
- Records of improvements and expenses

Improvements versus Repairs

- Repairs are deductible in the year incurred.
- Improvements that extend the property's life or increase value must be capitalized and depreciated.

Sale or Disposition of the Property

Calculating Gain or Loss

When the property is sold, the gain or loss is determined by comparing the sale price to the adjusted basis (original cost minus accumulated depreciation plus improvements).

Example:

- Sale Price: \$250,000
- Adjusted Basis: \$200,000 (initial) - \$10,000 (total depreciation) = \$190,000
- Gain: \$250,000 - \$190,000 = \$60,000

Tax Implications of Sale

- The gain may be subject to capital gains tax.

- Depreciation recapture may be taxed at ordinary income rates up to the amount of depreciation taken.

Conclusion: Strategic Considerations for Blue Company

The acquisition of a 27.5-year residential property for \$200,000 provides Blue Company with a valuable asset that can generate rental income and offer tax benefits through depreciation. Proper accounting treatment, including accurate allocation of the purchase price, timely depreciation, and record-keeping, is crucial for compliance and optimizing fiscal outcomes. Additionally, understanding the tax implications upon sale enables strategic planning for maximum benefits.

Key Takeaways:

- Accurate allocation between land and building is essential.
- Depreciation must be calculated prorately based on acquisition date.
- Maintenance of detailed records ensures compliance and facilitates future sale calculations.
- Strategic use of depreciation can enhance cash flow and tax planning.

Final Thoughts

Investments in residential real estate remain a significant component of corporate asset management. For Blue Company, adhering to IRS guidelines and maintaining meticulous records will support the long-term success of this acquisition, maximizing return on investment while ensuring compliance with tax laws.

This comprehensive overview offers clarity on the accounting and tax considerations surrounding the November 4, 2018, asset acquisition by Blue Company. For tailored advice, consulting with a professional accountant or tax advisor is recommended.

Frequently Asked Questions

What is the significance of Blue Company acquiring a 27.5-year residential real property on November 4, 2018?

This acquisition marks a long-term investment in residential real estate, likely for rental income or appreciation, with the 27.5-year period aligning with typical residential property depreciation schedules under tax laws.

How should Blue Company record the purchase of the residential property for \$200,000?

Blue Company should record the asset at its purchase price of \$200,000 on its books and capitalize it as a property asset, then depreciate it over its estimated useful life of 27.5 years.

What depreciation method is typically used for residential real estate like the property acquired by Blue Company?

Residential real estate is usually depreciated using the straight-line method over 27.5 years according to IRS guidelines.

How does the acquisition date of November 4, 2018, impact the depreciation schedule for the property?

Since the property was acquired on November 4, 2018, depreciation for that year should be prorated based on the number of months owned, meaning depreciation would be calculated from November 2018 onward.

Are there any tax implications associated with the acquisition of this residential property by Blue Company?

Yes, the purchase may impact Blue Company's tax deductions through depreciation expenses, and any future sale could result in capital gains or losses depending on the property's sale price and adjusted basis.

What factors should Blue Company consider when determining the useful life of the residential property?

Blue Company should consider IRS guidelines, the property's physical condition, location, and expected economic life, but the standard period for residential real estate is 27.5 years.

How does the purchase price of \$200,000 compare to the typical market value of similar residential properties?

The \$200,000 purchase price should be compared to appraisals and market data to determine if it reflects fair market value, which is important for accurate financial reporting and tax purposes.

What are the accounting journal entries involved in recording this property acquisition?

The typical entry would be: Debit 'Property Asset' for \$200,000 and Credit 'Cash' or 'Accounts Payable' for \$200,000, reflecting the purchase of the asset.

How does the 27.5-year depreciation schedule affect Blue Company's financial statements?

It spreads the cost of the property over 27.5 years, resulting in a yearly depreciation expense that reduces taxable income and reflects the asset's usage over its useful life in the financial statements.

What should Blue Company do if the property's fair market value changes significantly after acquisition?

Generally, residential real estate is not revalued upward unless impaired; however, if the asset becomes impaired, Blue Company should record an impairment loss. Otherwise, the book value remains based on the purchase price less accumulated depreciation.

Additional Resources

On November 4, 2018, Blue Company's acquisition of a 27.5-year residential real property for \$200,000 marked a significant strategic investment with far-reaching financial, tax, and operational implications. This transaction not only reflects Blue Company's growth trajectory but also exemplifies key principles of property acquisition, depreciation, and asset management within the realm of real estate accounting and corporate finance.

Introduction: Context and Significance of the Acquisition

Understanding the significance of Blue Company's purchase requires contextualizing the broader landscape of real estate investments and corporate asset management. As of late 2018, the real estate market experienced moderate growth, with residential properties remaining a vital component of diversified investment portfolios. For Blue Company, acquiring a residential property with a lengthy useful life—27.5 years—is indicative of a strategic decision to leverage the asset for operational purposes, future

income generation, or both.

This acquisition not only involves a straightforward purchase but also encompasses complex considerations such as valuation, depreciation schedules, tax implications, and long-term asset management. The decision to acquire a property at this specific time and for this particular amount underscores the company's strategic planning, financial health, and expectations of future cash flows.

Details of the Acquisition

Transaction Overview

- Date of Purchase: November 4, 2018
- Type of Asset: Residential real property (27.5-year class)
- Purchase Price: \$200,000
- Property Type: Likely a single-family home or multi-family residence, given the 27.5-year classification
- Purpose of Acquisition: Could include operational use, rental income, or strategic investment

Significance of the 27.5-Year Residential Property Class

In U.S. tax law, residential rental properties are categorized as 27.5-year property under the Modified Accelerated Cost Recovery System (MACRS). This classification influences depreciation calculations, tax deductions, and cash flow planning, making it a critical factor in the asset's financial profile.

Financial and Tax Implications of the Acquisition

Cost Basis and Valuation

The initial cost basis of the property is set at the purchase price of \$200,000. This figure serves as the foundation for future depreciation calculations, capital gains assessments, and potential tax deductions.

Key considerations include:

- Allocation of Purchase Price: If the property includes land and building, the purchase price must be allocated between the two, since land is not depreciable.
- Valuation Methods: Appraisals, market comparisons, or cost approaches help determine the fair allocation between land and structure.

Depreciation Mechanics

Depreciation is a non-cash expense that allocates the cost of the property over its useful life, providing a tax shield and influencing cash flow.

For residential real estate:

- Recovery Period: 27.5 years
- Depreciation Method: MACRS (Modified Accelerated Cost Recovery System), typically using the straight-line method over the recovery period
- Annual Depreciation Calculation:

$$\text{Annual Depreciation} = \frac{\text{Cost of Residential Building}}{27.5}$$

If, for example, land accounts for \$50,000 of the purchase price, the depreciable basis would be \$150,000, leading to an annual depreciation of approximately:

$$\frac{\$150,000}{27.5} \approx \$5,454.55$$

This depreciation reduces taxable income annually, providing immediate tax benefits.

Note: If the property was financed, interest expenses and other costs would also factor into overall financial analysis.

Accounting and Record-Keeping Considerations

Initial Recording

Upon acquisition, Blue Company would record the property on its books at the purchase price, allocating it between land and building components as appropriate. The journal entry might look like:

- Debit: Residential Property (Asset Account) – \$200,000
- Credit: Cash or Accounts Payable – \$200,000

If land is separated out, the entry would reflect the land's non-depreciable portion and the building's depreciable basis.

Depreciation Schedule and Record Maintenance

Accurate tracking of depreciation is essential for compliance and tax purposes. The company would set up a depreciation schedule, updating it annually to reflect the depreciation expense. This process ensures proper financial reporting and maximizes tax deductions.

Impact on Financial Statements

- Balance Sheet: The property appears as a fixed asset, with accumulated depreciation reducing its book value over time.
- Income Statement: Depreciation expense reduces net income, affecting profitability metrics.

Operational and Strategic Considerations

Use of the Property

Depending on Blue Company's core activities, the property could serve various functions:

- Employee housing or corporate offices
- Rental income generation
- Future appreciation and resale strategy

Property Management and Maintenance

Long-term ownership involves ongoing costs such as:

- Maintenance and repairs
- Property taxes
- Insurance
- Compliance with local housing regulations

Effective management ensures the property's value is preserved or enhanced, aligning with the company's strategic goals.

Potential for Appreciation or Depreciation

Real estate values fluctuate based on market conditions, economic factors, and local developments. Blue Company must monitor these trends to optimize

exit strategies or refinancing opportunities.

Legal and Regulatory Framework

Tax Regulations

The IRS's MACRS depreciation rules govern how residential property is depreciated, with specific guidelines on:

- How to allocate the purchase price
- The method of depreciation
- Recapture rules upon sale

Tax Implications upon Sale:

When Blue Company eventually disposes of the property, depreciation recapture may result in taxable gains, emphasizing the importance of strategic planning.

Local Zoning and Land Use Laws

Compliance with local zoning codes, building regulations, and land use policies is vital for legal ownership and operational efficiency.

Lease and Rental Regulations (if applicable)

If the property is rented, adherence to landlord-tenant laws and fair housing regulations is essential.

Long-Term Outlook and Strategic Planning

Asset Management

Proper management maximizes the property's value, whether through renovation, strategic leasing, or market repositioning.

Financial Planning

Incorporating the property into Blue Company's broader financial model involves:

- Forecasting income and expenses
- Planning for capital improvements
- Evaluating refinancing options

Exit Strategies

Possible exit strategies include:

- Sale of the property for capital gains
- Long-term hold for income and appreciation
- Reinvestment into other assets

Each approach depends on market conditions, tax implications, and corporate objectives.

Conclusion: Reflection on the Acquisition's Broader Impacts

Blue Company's purchase of a 27.5-year residential property for \$200,000 on November 4, 2018, exemplifies a strategic move rooted in sound financial principles and tax efficiency. The acquisition embodies core concepts of property valuation, depreciation, and long-term asset management. It also highlights the importance of aligning real estate investments with overall corporate strategies, financial health, and regulatory compliance.

This transaction underscores the multifaceted nature of real estate acquisitions, which involve not only initial capital outlay but also ongoing operational, legal, and financial considerations. As Blue Company navigates these complexities, its effective management of this asset will play a crucial role in its long-term growth and stability.

Ultimately, such acquisitions serve as a testament to the importance of comprehensive planning, precise accounting, and strategic foresight in leveraging real estate as a valuable component of corporate assets.

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