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Tax consequences of selling a double/duplex - by Russell Gullo

June 05, 2018 - Upstate New York

Owners of doubles and duplexes who occupy one of the units as their “principal residence” and rent out the other unit can be faced with one of the biggest tax nightmares if they dispose of this property without the proper advice.

The problem arises when the owners of this double or duplex decide to dispose of the property into a single-family home.

Most owners are not aware of the tax consequences they will be faced with on this transaction. The average consumer has heard that under Section 121 of the Internal Revenue Code if they go from one “principal residence” and as long as their gain (profit) doesn’t exceed $500,000, between husband and wife there is no taxation. This can be done once every 24 months and one even has the opportunity not to reinvest back into another “principal residence,” just take the money and run. As long as you lived there two of the last five years.

But the owners of the owner-occupied double or duplex also have been renting out the second unit and it’s not treated as a “principal residence” so it does not qualify for a total tax-deferment that we just spoke of.

Only the unit that was owner-occupied qualifies under Section 121 of the Internal Revenue Code. The other unit becomes taxable based on the gain (profit) at the time of disposition.

At this point, most (sellers) have no idea of the tax consequence and have never consulted with their tax adviser regarding this transaction.

If they continue through the transaction and decide in most cases that they want to go into a single-family home and more likely will procure additional financing and exhaust their entire savings to find out that come April 15, they owe a large tax liability which was triggered from the income producing unit of the double/duplex that was disposed of.

Savy real estate professionals should alert their client of the possible tax consequences they can be faced with and recommend they get tax advice from their accountant or CPA as to how to best structure this transaction.

If the sellers (taxpayers) of the double or duplex decide they want to go back into something other than just a single-family home which they will treat as their principal residence, they can be totally tax free on the principal residence. The income producing unit can become tax deferred by having a qualified intermediary structure it as a real estate exchange.

Under Section 1031 of the Internal Revenue Code, taxpayers disposing of income producing or investment-held properties have an opportunity to defer federal and, in most cases, state income tax associated with the gain (profit) by structuring the transaction as an exchange.

Today the taxpayer can sleep nights with the amending of Section 121 pertaining to the "principal residence" and with the deferred exchange regulations pertaining to income producing or investment-held properties under Section 1031

These guidelines, with the proper use of a "qualified intermediary" to quarterback the transaction together with the real estate professional, accountant/cpa and attorney of the taxpayer working together can accomplish this type of transaction.

Russell Gullo, CCIM, CEA, is founder and CEO of the R. J. Gullo Cos., Buffalo, N.Y.; and a national exchange/investment trainer for the American Institute of Real Estate Exchangors.