



Selling investment property, thinking you don't have a gain - by Russell Gullo

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There are many scenarios when selling income-producing real estate or investment-held property where you may experience a significant, and unexpected, gain (profit) and face a large tax liability that could have been avoided. If you encounter one of the examples below, make sure you speak with a professional Qualified Intermediary (QI) for real estate exchanges before entering into a contract of sale.

Common scenarios include:

- You have owned an income-producing property for many years and are fully depreciated, or close to fully depreciated, and are selling for a price greater than what you originally paid for the asset.
- You have owned an income-producing property and are fully depreciated, or close to fully depreciated, but your selling price is not much greater than your original purchase price.
- You are selling either an income-producing property or investment-held property for a price much greater than what you originally paid for the property.
- You have taken advantage of the historically low interest rates and have refinanced your income-producing property, but you have used all, or close to all, of your depreciation in your property and now that you are selling you don't think you have a large gain (profit) but you are confusing the term "gain" with your equity position. Gain (profit) is a tax term for the amount subject to taxation while equity is the difference between selling price and your mortgage. You may have no equity in your property yet still have a huge gain (profit).
- Because of the economic times, your property value of your income-producing asset may not be greater than your mortgage and you are selling the property or giving the property back to the lender through the process of a "deed in lieu of foreclosure" and think that you don't have a tax liability.

It's important to remember that if you sell an investment-held property or an income-producing property for more than what you paid for it, you are subject to tax on the gain. If you held the property for at least one-year then it is taxed at the favorable capital gains tax rate but with the New York State Income Tax, this could be a combined top tax rate of 29%.

In addition, if the property you are selling is an income-producing property, you have taken

depreciation expense, also known as cost recovery, which is a paper loss and a bookkeeping entry that allows you to shelter income throughout your holding period or recovery period depending on when you acquired your property and put it into service for IRS purposes. At disposition, you have to recapture every dollar that you took in depreciation expense, taxable at the federal and New York state level, for a potential combined top tax rate of 34% on depreciation expense.

So, depending on your situation, you may be faced with paying almost one third of your selling price in taxation. If you find yourself in one of the various examples above, you should consult with a professional Qualified Intermediary for real estate exchanges (also known as a 1031 exchange, deferred exchange, starker exchange or a TDX) who can save you thousands of dollars in unnecessary taxes.

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