Russell Gullo - So you are selling investment property and think you don't have a gain

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There are a number of situations in which you may be selling income-producing real estate or investment held property where you may experience a huge (gain) meaning profit and are not aware of it until it is to late and you are faced with a large tax liability that could have been avoided. If you are faced with one of the five examples in this article, make sure you speak with a professional "qualified intermediary" for real estate exchanges before entering into a contract of sale.

The following are a few of the most common scenarios that people are faced with today;

1. You have owned an income-producing property for many years and are fully depreciated or close to being fully depreciated and are selling for a price greater than what you originally paid for the asset.

2. You have owned an income-producing property and are fully depreciated or close to being fully depreciated, but your selling price is not much greater than your original purchase price.

3. You are selling either and income-producing property or investment held property that you will be selling for a much greater selling price than what you paid for the property.

4. You have taken advantage of the most favorable interest rates in fifty years and have refinanced your income-producing property, but again you have used all or close to all of your depreciation in your property and now that you are selling your property you don't think you have a large gain (profit) but you are confusing the term gain with your equity position. Gain/profit being a tax term which is the amount subject to taxation and equity being the difference between selling price less your mortgage equals your equity position. You may have no equity in your property and have a huge gain/profit.

5. 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 what we call a deed in lieu of foreclosure and think that you don't have a tax problem.

If you find yourself fitting into any of these examples, we need to stop and consult with a professional "qualified intermediary" for real estate exchanges who can save you thousands of dollars in unnecessary taxes.

That is right. First of all if you sell an investment held property or even an income-producing property for a price which is greater than what you paid for it you are subject to tax on a gain which if you held the property for at least one year then it is taxed at the favorable capital gains tax rate of 15% but don't forget New York State Income Tax which its top rate is approximately 9% for a combined tax rate of 24%.

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. Over what's called your recovery period depending on when you acquired your property and put it into service for I.R.S. purposes. For every dollar that you took in depreciation expense, you have to recapture the depreciation which means it is taxable at a rate of 25% federally and don't forget New York State with a top rate of approx. 9% for a combined tax rate of 34% on the depreciation expense.

So, you may be faced with paying almost a third of your selling price in taxation depending on your situation. Or you may be faced with not only paying on the recapture of depreciation and New York State but also on the capital gain, the increase of selling price over your purchase price (what we call your appreciation).

If you find yourself fitting into any of these example, you have the opportunity to pay no tax through the process known as a "1031" exchange, real estate exchange, deferred exchange starker exchange or a T.D.X. all meaning the same and allowing for this favorable tax treatment under Section "1031" of the Internal Revenue Code.

Don't forget you will need to consult with a professional "qualified intermediary" who is in the business of setting up 1031 exchanges in order to have the opportunity to pay no tax.

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