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The impact of the new taxes on commercial and investment properties

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Capital Gains Taxes

If the taxpayer is in the 10% or 15% tax bracket (income up to $36,250 single, $72,500 married AGI) there is no Capital Gain Tax. Above these income thresholds, up to $400,000 (AGI) for individuals and $450,000 (AGI) if married filing jointly, the capital gains tax on appreciation will be 15%. Above those limits the Capital Gains Tax on appreciation is now 20%.

However a new Medicare Surcharge, 3.8% tax is due on individuals, estates and trusts if the taxpayer has Net Investment Income and adjusted gross income of $200,000 individual or $250,000 married. The tax is based on the excess AGI or the Net Investment Income, whatever the lesser amount is. Consequently some taxpayers in the 15% Capital Gains Bracket will effectively be paying 18.3% and those in the 20% Capital Gains Bracket may be paying effectively 23.8%

The sale of your personal residence is subject to Capital Gains Tax on appreciation of value. However, homeowners may exclude the first $250,000 in gain ($500,000 if married and filing jointly) on the sale of one home every two years. To be eligible home seller must have owned and resided in the home for two of the last five years before the sale.

A home was bought 20 years ago for $125,000, over the years improvements were made costing $30,000. Now the home is being sold for $885,000. I am not going to explain the accounting but focus on the capital gains tax.

Residential Example

Married Couple Filing Jointly

Purchase price (20 yrs ago): $125,000

Improvements: +30,000

Adjusted Basis: $155,000

Sale Price: $885,000

Less Adjusted Basis: -155,000

Less Cost of Sale: -56,640

Net Profits: $673,360

Capital Gain Exclusion: -500,000

Capital Gain: $173,360

Capital Gains Tax (15%): $26,004

As a married couple filing jointly they are eligible for the $500,000 exclusion reducing their taxable gain. But they still owe $26,004 in capital gains taxes. Based on income the Medicare Surcharge Tax may also apply.

Residential Example

Single Taxpayer

Purchase price (20 yrs ago): $125,000
Improvements: +30,000
Adjusted Basis: $155,000
Sale Price: $885,000
Less Adjusted Basis: -155,000
Less Cost of Sale: -56,640
Net Profits: $673,360
Capital Gain Exclusion: -250,000
Capital Gain: $423,360
Capital Gains Tax (20%): $84,672
Medicare Surtax ($223,360 X .038): $8,488

As a single taxpayer the residential exclusion is $250,000, which creates a much higher gain and consequent tax bracket and taxes due.

On commercial and investment properties it is required that the building be depreciated. Land does not depreciate. Residential investment properties depreciate over 27.5 years and commercial properties depreciate over 39 years.

Your personal residence is not depreciable.

Recaptured Depreciation Tax - Upon sale of commercial and investment property there is a second capital gains tax of 25% on depreciation recapture.

A commercial property was purchased 20 years ago for $125,000. It was improved in stages totaling $130,000. Today it is being sold for $885,000.

What are the
Capital Gains Taxes?

Calculate Depreciation
Purchase price (20 years ago): $125,000
Less Land Value: - $25,000
Building Value: $100,000
Depreciation (39 year schedule): $51,282

Depreciation taken to date on building.
$100,000¸ 39 years = $2,564 per year
$2,564 X 20 years = $51,282

Depreciation must also be taken on capital improvements
Improvements   Basis $130,000

(Based on a 39-year schedule with various start dates; since 2003 capital improvements in commercial buildings may be depreciated over 15 years, this ends 12/31/2013) For this example we will use $35,000 as depreciation taken on improvements to date.

Total depreciation taken on building and improvements to date.
$51,282 + $35,000 = $86,282
Purchase price (20 yrs a go): $125,000
+Improvements: +130,000
- Depreciation: - 86,282
Adjusted Basis: $168,718

Sale Price: $885,000
Less Adjusted Basis: -168,718
Less Cost of Sale: -56,640
Net Profits (Capital Gain): $659,642

Gain from Depreciation: $86,282
Gain from Appreciation: $573,360
Total Capital Gains: $659,642

Capital Gains Taxes:
Depreciation Recapture Tax (25%) $86,282 X .25 = $21,570
Tax on Appreciation (20%) $573,360 X .20 = $114,672
Medicare Surtax (3.8%)
If Single ($659,642 - $200,000 = $459,642 X .038) $17,466
Total Federal Capital Gains Tax $153,708
On a sale of $885,000
The following topics have many rules and exclusions; direct your clients to discuss these matters with their tax advisor or accountant.
50% Bonus Depreciation - accelerated depreciation was 100% in 2012; for 2013 it is 50%. This applies only to new (not used) equipment i.e. computers, printers, office furniture, carpeting, also new vehicles used in your business and any to tangible personal property, construction and agricultural equipment,

Enhanced Expending, section 179 Deduction - limits have been increased to capital purchase up to $2 million with maximum deduction of $500,000. This includes: new and used equipment, computer software (off the shelf), machinery, office equipment, business Vehicles and tangible goods used in your business.

Qualified property for enhanced expensing, must be used in trade or business, includes equipment and the cost of updating or refurbishing a restaurant, retail store and other leased commercial property. (Improvements to an existing building) Qualified restaurant property also includes the cost of a new building. Real property improvements are limited to a $250,000 deduction, of the $500,000 limit.
The 15-year recovery period for leasehold improvements, restaurant property, and retail property was made retroactive to January 1, 2012; now to expire December 31, 2013. When this expires the depreciation recovery period for these items will revert to 39 years.
Energy Tax Credits
The $500 Energy Efficient Home Improvements for Primary Residence has been extended through 12/31/2013
Up to $1.80 PSF owner or tenant, for new construction or rehab of commercial buildings, that save 50% in energy costs. (heat, water, light, cooling) through 12/31/2013
30% of cost Tax Credit for geothermal or solar installations (Residential or Commercial) through 12/31/2016.

Disclaimer: All taxpayers should discuss their situation with a professional tax advisor or accountant. Certain of the tax changes have specific rules and exclusions. As agents we can talk about taxes, but always refer your client to a tax professional.

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