



The Gem

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Sale of a Rental Property May Generate Tax Benefits

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In the current economy many people have had to sell rental properties because of lost tenants or simply to generate some extra cash. There may be significant tax deductions generated from the sale of a property. It is also possible there may be no tax to pay, even if the property was sold at a gain.

The first thing to determine is the gain or loss on the sale of the property. Gain or loss is generally the difference between the gross sales price less the adjusted basis of the property and any selling costs (i.e., commission and closing costs). Adjusted basis is the original cost of the property less the amount of depreciation allowed or allowable. (It is possible that the tax basis may be more than the original cost if a spouse passed away and there was a step-up in basis. Or, it is possible the basis may be less than original purchase price if the property was acquired in a 1031 exchange. These are separate topics that should be discussed with your tax advisor.)

Gain on Sale of Rental Property – The gain on the sale of rental real estate qualifies for special treatment under IRS Code Section 1231. If there was a gain on the sale, the gain, up to the extent of depreciation, is taxed at a maximum federal rate of 25%. If the property was held for more than one year, the gain is long-term and gain in excess of

depreciation is taxed at a 15% rate. However, if one has capital losses in the current year, or capital loss carryovers from a prior year, capital losses can be used to offset gain on the sale of the rental property, and it is possible to pay no tax on the gain. Losses from stock sales can be used to offset gain from real estate sales.

Loss on the Sale of Rental Property – A loss on the sale of real estate qualifies for special tax treatment. A loss is treated as an ordinary loss and can be used to offset other ordinary income such as wages or income from S corporations or LLC's. If you are in the highest tax bracket for 2010, this can mean effective tax savings of 35% of the loss for federal income tax purposes and 9.3% for state income tax purposes.

Suspended Real Estate Losses – A number of taxpayers that generated losses from rental activities in the past were not able to use all or part of the losses if adjusted gross income exceeded \$100,000 or their annual losses exceeded \$25,000. Any losses in excess of the allowed amounts resulted in suspended passive losses. In many cases, the suspended passive losses can be significant. The good news is that when a property is sold, any unused suspended passive loss allocated to the property sold are "freed up" in the year of sale and can be used to offset any type of income, including ordinary income. The suspended passive loss can be fully utilized, even if it exceeds the gain from the related property sale, or, even if the property was sold at a loss.

As you are reviewing the status and plans for any rental properties you hold, keep in mind that with proper planning there may be tax savings generated on the sale of your property. Please call us to assess your particular situation so that we can help you take advantage of any tax saving opportunities that may be available.

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