

A Section 1031 Exchange May Be Helpful Even When a Property is Sold at a Loss

In today's real estate market sellers often have to accept a sale price which is less than what was originally paid for a property. Sellers are often dismayed to learn that even if the property is sold at a "loss" or at a foreclosure sale, income taxes may be due.

A taxable gain on the sale of property can result even though a taxpayer sells the property for less than what was paid for it when it was purchased. Income taxes are due when a taxpayer sells property at a net sale price which exceeds the "tax basis" in the property as distinguished from what was paid for the property when it was acquired.

Tax basis is comprised of the following elements for a property which is purchased:

- Purchase price paid for the property.
- Plus improvements made to the property subsequent to the purchase.
- Minus any depreciation taken on the property after purchase.
- Minus any deferred gain from a 1031 exchange when the property was acquired (if any).

Since depreciation and deferred gain from a 1031 exchange decrease tax basis, gain can result even though the property is sold for less than what was paid for it. For example, if a property that is being sold for \$400,000 was acquired a few years ago for \$500,000 and currently has a tax basis of less than \$400,000, a taxable gain will result on the sale. A 1031 Exchange can be utilized to defer the income taxes on this gain if

the investor is going to reinvest the proceeds of the sale in replacement real estate.

The gain on the sale of property is taxed at capital gains tax rates. The maximum long-term capital gains tax rates for property held for 12 months or longer can be summarized as follows:

- 25% for the amount of the gain equal to depreciation taken on the property.
- 15% for the remainder of the gain (20% after January 1, 2011 unless new tax law extends the 15% rate).
- Plus a possible alternative minimum tax which often occurs when a large capital gain is reported.
- Plus state income taxes which will be due on the sale.

Talk to your tax advisor when you are anticipating a sale of your property. You may find that a 1031 exchange can save you taxes even if you are selling the property at a loss.

If you have any questions we can help with, contact us at 888-367-1031 or email us at 1031@1031cpas.com. Our Exchange Manual is also available, free of charge at www.1031cpas.com. 1031 Corporation is the Intermediary of choice for thousands of real estate professionals, CPAs and investors.

Larry Jensen
Vice President
larry.jensen@1031cpas.com

Give us a call today toll free at 888-367-1031

1STBANK



1031cpas.com or efirstbank.com/business/1031

Member FDIC