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# TAXABLE GAINS ON SALE OF PRIVATELY-HELD REAL ESTATE

When a real estate asset is sold, the gain or loss on sale will vary, due to several factors. The key factors will first be the potential taxable gain or loss on the sale, measured by the "tax basis" of the property sold, and, how it was used, or "held" by the taxpayer.

There are sometimes opportunities to reduce or fully defer a potentially taxable gain on sale. These are discussed below in the context of "tax basis" for a general understanding of what the options and/or requirements under the U.S. Internal Revenue Code are.

1). Cost basis – what the taxpayer initially paid for the property

2). Adjusted basis – the cost (or other) basis:
- adjusted upward for improvements,
- reduced downward for accumulated depreciation taken during the holding period by the taxpayer, or, for any other reduction to basis (such as abandonment of some portion of the property basis due to casualty or other reason)

3). Gift basis – when a taxpayer receives property as a gift, they take as their own "gift" basis the lesser of the donor's cost or adjusted basis, or the fair market value at the time of the gift; this is also known as a "carryover basis"

4). Inherited basis (aka stepped-up basis) – when a taxpayer inherits or receives property from an estate, their basis is equal to the fair market value of the property as stated by the decedent's estate (or later as per IRS if examined), determined as of the date of death of the decedent

**5)**. Deferral of Gain on Sale, via IRC Section 1031- any deferral of gain by a taxpayer in a Section 1031 Deferred Exchange is deducted from the purchase or cost basis of the replacement property. This way, the Section 1031 basis "accounts" for the gain not taxed, but deferred by imbedding the deferred gain into the tax basis of the replacement property

6). Exclusion of Gain on Sale of personal residence, via IRC Section 121 – when a personal residence is sold, if a taxpayer has lived in the house as their personal residence for (any) two of the five years preceding sale, $250,000 of any gain on sale is excluded under IRC Section 121. For a married couple filing either separately or jointly, the total possible excluded gain on sale will be $500,000, one-half to each spouse passing the two year of five residency test

7). Character of Taxation of a Gain on Sale – most gains on sale of real estate will be a capital gain. There are exceptions for depreciation recapture in the case of property held for business use, on which depreciation deductions have been claimed, or "allowable", known as "depreciation recapture".

8). Net Investment Income Tax of 3.8%; when applicable, and when not: the NII ("Medicare") tax on net passive capital gains will apply to gains on the sale of a personal residences by a taxpayer if their adjusted gross income is above the applicable NII limitation amounts. However, if the property was held for business use and the taxpayer was actively involved in the management and operation of the property, or business conducted thereon, there is no NII tax due on the sale. Examples of actively conducted business use would be rental of the property or, a factory, or, restaurant building used in a taxpayer's business.

NOTES:

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