



### CONSIDER THESE ISSUES BEFORE CLOSING ON PROPERTY HELD FOR INVESTMENT

Assume a California taxpayer has held an investment property for many years and will have \$500,000 in net proceeds after closing. Also assume this property has \$500,000 of capital gain and \$200,000 of this gain is due to depreciation recapture. As you can see in the comparison below, the taxpayer who performs a 1031 exchange can obtain considerably higher investment returns from deferring the payment of capital gain taxes and other taxes. The potential to obtain a low rate for financing can provide a unique opportunity for taxpayers to lock-in excellent loan terms. Taxpayers should explore the possibility of exchanging before closing on the sale of investment property and review with their tax advisor.

	SALE (CASH OUT)	1031 EXCHANGE (REINVEST)
Capital Gain Taxes Owed	\$141,500 *	\$0 (no taxes owed in the current tax year)
Net Income to Invest	\$358,500 (proceeds less taxes owed) 1-5% possible cash flow (assume 3%)	\$500,000 (entire amount of proceeds received). Many real estate investments provide 6-10% cash flow (assume 8%)
Possible Income	Bank CD, Bond Fund, Money Market. Assuming a 3% ** return on \$358,500 \$10,755/annual income \$896/monthly income	Residential Rental, Commercial, Agricultural Land, etc. Assuming a 8% return on \$500,000 \$40,000/annual income \$3,333/monthly income
Preferential Tax Treatment	Income is not tax-favored if earnings are in a non tax-qualified account. May be fully taxable.	Income generated is tax-favored. Income can be partially sheltered with write-offs. Depreciation tax benefits are also available.
Liquidity	Very liquid if 100% cash	Real estate is generally not very liquid.
Diversification	Yes	Yes, but must reinvest in real property. May diversify by asset class and/or geography.
Time Restrictions	None	Yes, 45 days to identify replacement property. Maximum of 180 days to close on replacement property.
Replacement Asset Basics	Basis equals purchase price	Only partial basis for new depreciation. Basis equals purchase price minus deferred gain.

#### FOOTNOTES:

\* Depreciation Recapture:  $\$200,000 \times 25\% = \$50,000$ ; Remaining Federal Capital Gain:  $\$300,000 \times 15\% = \$45,000$ ; State Taxes:  $\$500,000 \times 9.3\% = \$46,500$   
Total Capital Gain Taxes = \$141,500; After-Tax Proceeds Available:  $\$500,000 - \$141,500 = \$358,500$

\*\* Today's inordinately low rates of return for money market accounts, bank CDs and other liquid investments tilt the consideration in favor of exchanging.

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