



SALE OF REAL ESTATE - TAX ISSUES

Generally, real estate is a capital asset. If the taxpayer is classified as a dealer, then the real estate may be stock-in-trade and not a capital asset. The sale of stock-in-trade is ordinary income. The sale of real estate may result in the recognition and realization of gain which is subject to State and Federal income taxes or of loss.

1. Taxation of the Gain/Loss.
 - A. **Gain.** If the sale resulted in gain, tax must be paid on the gain. Gain equals sales price minus expenses of sale, minus adjusted basis in the property. Adjusted basis is usually cost plus improvements, minus depreciation.
 - B. **Rate.** For Federal purposes, the maximum tax rate that can be imposed on the long-term gain is 15%. If there has been depreciation taken, the depreciation recapture may be taxed at 25%. For State of Wisconsin purposes, a capital gain deduction of 60% is allowed if the asset has been held for more than one year. This deduction results in an effective State tax rate of 2.7% (Regular Maximum Rate 6.75% x 40%).
 - C. **Holding Periods.** To receive the long-term capital gains rates, the taxpayer must have held the property more than one year.
 - D. **Capital Loss.** Capital Loss offsets capital gain dollar for dollar. If there are no capital gains, then the taxpayer may deduct up to \$3,000 of capital loss per year. For Wisconsin purposes, the taxpayer may deduct up to \$500 of capital loss per year.
 - E. **Alternative Minimum Tax.** The sale may cause the taxpayer to be subject to the Alternative Minimum Tax (AMT). In effect, this would apply to the taxpayer's non-capital gain income. The tax rate for the non-capital gain income would be 26% and the taxpayer loses itemized deductions for state income taxes paid and real estate taxes paid.
2. **Exception - Sale of Personal Residence.** The current exclusion of gain from sale of principal residence replaced the former "once-in-a-lifetime exclusion." The old "once in a lifetime exclusion" was limited to \$125,000 of gain and could only be used once in the taxpayer's lifetime. The current exclusion allows a taxpayer to exclude up to

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\$500,000 of gain for married filing jointly status and \$250,000 of gain for single status on the sale of the principal residence. The taxpayer must have owned and used the residence as his/her principal residence for two out of the preceding five years. The current exclusion can be used every two years. It is not limited to once in a lifetime.

3. **Exception - Like Kind Exchange.** The tax on the gain may be deferred if the taxpayer enters into a like-kind exchange. The taxpayer must exchange real estate for real estate. The replacement real estate must be of equal or greater value. The exchange may be simultaneous or delayed. If delayed, strict time limits must be met. The exchange transaction must be stated in the Offer to Purchase and the title company must be engaged to act as the intermediary. The tax is not eliminated it is deferred until the taxpayer cashes out the real estate investment.
4. **Estimated Payments.** If the sale of real estate will result in tax, the taxpayer may want to make or increase estimated tax payments. If the taxpayer has not made sufficient estimated tax payments (there are alternative calculations), he may be subject to an underpayment penalty. The taxpayer should have his estimates reviewed by his tax preparer.
5. **Reporting Requirements. Transaction.** Real Estate sales are reported to the Internal Revenue Service by the entity preparing the closing statement. This is done on Form 1099-S. The Seller receives a copy of the 1099-S. The IRS will match the information on the 1099-S to the Seller's income tax return so the transaction must be reported whether or not tax is due.