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Uncertainty Over Extension of Reduced Capital Gains Tax May Spur End of Year Real Estate Deals

November 2, 2010

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Currently, no one knows whether **Congress** and the **President** will take action this year to retain the historically low long-term **capital gains rates**, which are scheduled to increase to 20% effective January 1, 2011. This uncertainty has motivated some real estate sellers to contemplate closing in 2010 in order to avoid potentially increased capital gains taxes next year.

Presently, the **top long-term capital gains tax rate is 15%** as a result of the Tax Increase Prevention and Reconciliation Act of 2005, which extended many of the Bush-era tax cuts through the end of 2010.

The following is a basic example of the amount of savings that an owner could realize by selling his or her real estate in 2010, with the assumption that the top long-term capital gains tax rate will in fact increase in 2011 by 5% to 20%:

- Original Purchase Price **- $2,000,000**
- Depreciation - **$1,000,000**
- Improvements - **$250,000**
- Basis - **$1,250,000** ($2,000,000 - $1,000,000 + $250,000)
- 2010 Sales Price - **$4,000,000**
- Gain - **$2,750,000** ($4,000,000 - $1,250,000)
- **Potential Savings if Congress Does Not Retain 15% Rate - $137,500 ($2,750,000 x 5%)**

Keep in mind that if an individual or flow-through seller takes back cash and an installment note in exchange for the property, the selling taxpayer will normally use the installment method to report gain on a deferred basis with respect to that portion of the proceeds received when principal payments are made on the installment note. While deferral of income recognition is normally good tax planning, long-term capital gains deferred into years beyond December 31, 2010 are expected to be taxed at the higher 20% rate referenced above. Taxpayers can elect out of the installment method, and pay the tax on the gain in the year of sale. The decision to accelerate payment of income taxes into 2010 (without receipt of principal payments on the installment note) to obtain a rate reduction from 20% to 15% will be a tough decision for most taxpayers.

There are a **number of very unique factors,** such as **market conditions,** which will influence a real estate owner's decision to sell an asset. Watching what Washington does at the end of this year with respect to future tax rates is just one element which should be considered together with market factors. Taxpayers should consult with their professional tax advisors before deciding to take advantage of 2010's historically low long-term capital gains tax rate.

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