Selling Your Income Property

3 winning tax strategies

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The decision to sell your income property should made with consideration of what you will do after the sale of the property. This is similar to the way you would approach your estate planning.

Tax consequences always cause great concern and are often the primary issue when selling property. Consult with a CPA and/or a tax attorney who is well versed in this area and has direct experience in owning and selling income property. There are several methods for deferring taxes. Your basis in the property has direct correlation to your after tax dollars. This is a major component.

Tax Deferred Exchange

The 1031 Tax Deferred Exchange is a very common tax deferral vehicle. The seller of a property has the proceeds from a sale held with a neutral third party known as an accommodator. The seller has 45 days from the close of escrow to nominate (inform the IRS) another like-kind property to exchange into and must close escrow on the "up leg" (replacement) property within 180 days from the sale of the down leg (relinquished) property. The Seller can nominate up to three properties or more than three if the total of all the identified properties does not exceed 200% of the total net sale of the relinquished property. Escrow must close on one of the nominated properties and may not be substituted for another property. The exchange can be simultaneous with the property being sold and the up leg closing concurrently.

Finding the up leg property before consummating the sale on the down leg can relieve a lot of stress and this can be accommodated by having the options to extend the escrow periods on the down leg. When the funds to purchase the up leg are contingent on a sale from the down leg which has not yet been sold, the seller is not in as strong of a position to negotiate as a buyer on the up leg property.

Carrying Back Paper

Carrying back paper is another common vehicle that can reduce tax consequences and also achieve a higher sales price of a property. A seller can carry back a First or Second Trust Deed. Interest is taxed as ordinary income in the year in which it is received. The seller should secure a reasonable down payment and negotiate an interest rate which will provide a greater return than what is available through institutional lenders. An Assignment of Rents should be recorded when a seller is carrying back a Deed Of Trust which will allow the seller to collect the rents in the event that the buyer defaults and to proceed with foreclosing on the property. The security for the note is the property itself.

Charitable Remainder Trust

Another vehicle that is not utilized enough is the Charitable Remainder Trust (CRT) which has many benefits. It provides an income consistent with the income already being received from the property without the responsibility of owning and operating the property. There is tremendous tax-write-offs for up to 5 years and the property owner can purchase a life insurance policy equivalent to or greater than the value of the real estate which can be passed on tax free to heirs. Most importantly, a CRT benefits such a wide variety of non profit charitable institutions and organizations which save lives, provide medical care including services to the elderly and children, supplements educational and research projects and provide resources for so many with vital needs. What an amazing legacy to leave behind.

Of course, sometimes it simply makes sense to sell the property and move on. We all meet our maker and the Tax Man still lives on with Inheritance Tax. For federal estate taxes the current limit is 5 Million for an individual and 10 Million for a couple. The sage advice is to consider the choices that are right for you in relation to the season of your life and make choices based on accurate information before you sell. AA