Capital Gain Tax Rates

1031 Exchanges Can Defer the 3.8% NIIT and Capital Gains Taxes

1031

Knowledge

The familiar adage, *"It's not how much you make, but how much you keep"* rings truer than ever for taxpayers who are real estate investors facing today's tax rates. Fortunately, IRC Section 1031, a provision in the tax code since 1921, provides critically needed tax deferral. Reflected below is a summary of the four ways a taxpayer could be taxed on the sale of an investment property if they do not take advantage of a 1031 exchange:

1. **Depreciation Recapture:** First, taxpayers will be taxed at a rate of 25% on all depreciation recapture.
2. **Federal Capital Gain Taxes:** Next, taxpayers owe federal capital gain taxes on the remaining economic gain depending upon their taxable income. Taxpayers exceeding the $518,900, taxable income threshold for single filers and married couples filing jointly with over $583,750 in taxable income will be subject to a 20% capital gain tax rate. The 15% capital gain tax rate generally applies to taxpayers below these threshold income amounts.
3. **Net Investment Income Tax Pursuant to IRC Section 1411:** When applicable, an additional 3.8% surtax applies to taxpayers with "net investment income" who exceed threshold income amounts of $200,000 for single filers and $250,000 for married couples filing jointly. Pursuant to IRC §1411, "net investment income" includes interest, dividends, capital gains, retirement income and income from partnerships (as well as other forms of "unearned income").
4. **State Taxes:** Last, taxpayers must also take into account the applicable state tax, if any, to determine their total taxes owed.

Despite high overall taxes owed when combining these four levels of taxation at the disposition of an investment property, one aspect of the tax code provides real estate investors with a significant tax advantage. Section 1031 exchanges allow taxpayers holding real property for investment purposes to defer taxes that would otherwise be recognized upon the sale of investment property.

Federal Capital Gain Tax Rates

Single Taxpayer	Married Filing Jointly	Capital Gain Tax Rate	Section 1411 NIIT Surtax*	Combined Tax Rate
$0 - $47,025	$0 - $94,050	0%	0%	**0%**
$47,026 - $518,900	$94,051 - $583,750	15%	0%	**15%**
$200,001 - $518,899	$250,001 - $583,749	15%	3.8%	**18.8%**
$518,900+	$583,749+	20%	3.8%	**23.8%**

*The 3.8% NIIT surtax only applies to "net investment income" as defined in IRC §1411.

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