

# A Sale vs. an Exchange

## Analyze the Benefits Before Selling

1031

Knowledge

The benefits of 1031 exchanges can be significant for taxpayers who own investment property. Taxpayers have the potential to defer all capital gain taxes, depreciation recapture, the net investment income tax (NIIT), and state taxes. If the requirements of a valid 1031 exchange are met, capital gain recognition will be deferred until the taxpayer chooses to recognize it.

An Example: A married couple filing jointly sells an investment property in California for \$1,000,000 (net of closing costs) with no debt. The couple originally purchased the property for \$400,000. Seventy-five percent, or \$300,000 of the initial purchase price, was allocated to the building and has been fully depreciated. The capital gain is approximately \$900,000 (today's sales price of \$1,000,000 minus the net adjusted basis of \$100,000). This is the only source of the couple's investment income. The couple's modified adjusted gross income is \$1,400,000 (which includes income from other sources and capital gain from this sale) for purposes of calculating the net investment income tax. The couple will be taxed at 25% for their prior depreciation deductions taken, 20% federal capital gains tax rate, the 3.8% net investment income tax and they will be in the 13.3% California state tax bracket.

<b>Today's Net Sales Price (after closing costs)</b>	\$1,000,000
<b>Less taxes owed</b>	
\$300,000 depreciation recapture @ 25%	= \$75,000
\$600,000 federal capital gain @ 20%	= \$120,000
\$900,000 net investment income tax @ 3.8%	= \$34,200
\$900,000 state tax @ 13.3%	= <u>\$119,700</u>
<b>Total taxes owed</b>	<b>= \$348,900</b>
<b>After-Tax Net Equity</b>	
\$1,000,000 – \$348,900	= <b>\$651,100</b>
<b>1031 Exchange Gross Equity</b>	= \$1,000,000
<b>Taxable Sale: Net Equity x 4</b>	= \$2,604,400
<b>1031 Exchange: Gross Equity x 4</b>	= \$4,000,000

The California taxpayers in this example could potentially purchase a replacement property that is worth approximately \$1.4 million more by performing a 1031 exchange instead of a taxable sale. Exchanges provide the opportunity to preserve equity, increase cash flow from larger replacement properties, and enable taxpayers to maximize return on investment.

### Compliments of:



HQ 800.282.1031 | NY 866.394.1031  
[apiexchange.com](http://apiexchange.com) | [info@apiexchange.com](mailto:info@apiexchange.com)

Asset Preservation, Inc. (API) is a qualified intermediary as defined in the regulations under Internal Revenue Code §1031. Neither API, its officers or employees are authorized or permitted under applicable laws to provide tax or legal advice to any client or prospective client of API. The tax related information contained herein or in any other communication that you may have with a representative of API should not be construed as tax or legal advice specific to your situation and should not be relied upon in making any business, legal or tax related decision. A proper evaluation of the benefits and risks associated with a particular transaction or tax return position often requires advice from a competent tax and/or legal advisor familiar with your specific transaction, objectives and the relevant facts. We strongly urge you to involve your tax and/or legal advisor (or to seek such advice) in any significant real estate or business related transaction. © 2018 Asset Preservation, Inc. All rights reserved.