

CAPITAL GAIN TAX INCREASES COMING

Apr, 2010

Look out ahead, folks! The combination of two upcoming changes to federal capital gain taxes will have a tremendous impact on those of us who own land, invest in real estate, own stocks or mutual funds, or receive other types of investment income.

Beginning January 1, 2011, the tax cuts instituted during the Bush presidency will expire. As that relates to capital gain rates, the result will be an increase from the current 15% to 20%. (A 33% increase!) In addition, there is a small provision within the thousands of pages of legislation of the new Health Care bill that President Obama signed into law on March 23, 2010, that also impacts federal capital gain taxes. The bill includes a 3.8% "Medicare payroll tax" on capital gains and other investments. The 3.8% increase takes effect on January 1, 2013. It does have some income threshold requirements; i.e., your income must be over a certain level for it to apply to you. Added together, these two changes will result in a federal capital gain tax rate of 23.8% for many Americans, nearly a 60% increase over today's 15% rate!



It appears to this author that if you were ever thinking of selling land or investment real estate without using a Section 1031 exchange, the remainder of the year 2010 might be the time to do it. You can avoid the jump from 15% to 20% that happens at the end of 2010 if you close your transaction prior to December 31, 2010.

Keep in mind that you can still avoid paying 100% of those taxes today by utilizing a Section 1031 exchange.



Here is an example: Bob bought his dream plot of land in 1990 - 160 acres at \$600 per acre, for a total of \$96,000. That number represents that basis in his unimproved land. Today, his dream has changed and he is ready to sell to a buyer at \$1,700 per acre, or \$272,000 total. The difference between \$272,000 and \$96,000 (\$176,000) is Bob's capital gain. His tax liability on this gain will depend upon when the closing occurs. Prior to the end of 2010, at 15%, the tax would be \$26,400. After January 1, 2011, when the rate goes to 20%, the tax would jump to \$35,200. And after January 1, 2013, if the Medicare kicker applies to Bob, the full 23.8% applies. Federal capital gain taxes would be \$41,888, over \$15,000 more than today's 15% rate. In all of those cases, Bob can defer the full amount of tax through the use of a Section 1031

exchange and investment into a new dream plot, other investment real estate, or even some types of passive real estate investments.

As you contemplate these upcoming changes, remember that the facts above only refer to federal capital gain tax implications. There are two other factors to remember. First, if your property is improved in any way (for example, fencing, tiling, or structures of any kind), you will be required to recapture any depreciation you took or were entitled to take, even if you did not take depreciation! Second, do not overlook the impact of your state's capital gain tax, if any. In the state of Iowa, for instance, the capital gain tax is 8.98% for nearly all transactions.

If you have questions, please feel free to get in touch. This is a fluid situation so it is difficult to know all of the answers, but we will make every effort to help you formulate a reasonable plan of action. This information should not be construed as tax or legal advice and you are strongly urged to discuss your personal situation with your trusted advisors.

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The professionals at Iowa Equity Exchange understand the complex rules of Section 1031 exchanges. We can help simplify this information for you and your clients. Section 1031 exchanges are our only business. We are members of the Federation of Exchange Accommodators, the only national association that is dedicated to the protection of the consumer in 1031 transactions. Less than 2% of all qualified intermediary service providers nationwide are members of this organization. We can creatively and strategically assist you and your clients with the sale or purchase of assets in order to maximize the tax deferral opportunities. Please contact us at your convenience.



Note: Per 1031 regulations, Iowa Equity Exchange cannot give tax and/or legal advice. Every taxpayer should review specific transactions and potential tax consequences with his or her personal tax and/or legal advisor.