

Midtown Landlord & Neighborhood Association

3rd Precinct Workshop
For
Rental Property Owners

Sale of Investment Property

Scenario A:

Cash shortfall to pay Income Taxes due on the Sales transaction.

Scenario B:

Cash shortfall at Closing due to Market Downturn, plus Taxes due on the Sales transaction.

Scenario A: Assumptions

- Investor buys Duplex on 01/01/1980 for \$30,000.
- Allocates \$5,000 to the Land
- Allocates \$25,000 to the Building
- Property is fully depreciated by 2005 (\$1000 / year)
- Writes off repairs - No Capitalized Improvements
- Refinances in 2006 – new loan \$200,000 (80% of FMV of \$250,000). Cash proceeds for personal use.
- Sells the Property on 12/31/2007 for \$240,000
- Balance of Loan Payoff at Closing is \$195,000

Tax Consequence (A)

■ Sale Price	\$240,000	
Less Commission	12,000	(5%)
Other Costs	5,000	
■ Net Sales Price	<hr/> \$223,000	
■ Less Tax Basis	5,000	(\$30K - \$25K)
■ LT Capital Gain	<hr/> \$218,000	
■ Total Tax	\$ 52,640	Fed & State

Tax Calculation (A)

■ Depreciation	\$ 6,250	Recaptured
(\$25,000 @ 25%)		
■ L/T Cap Gain	28,950	(218K-25K)
(\$193,000 @ 15%)	<hr/>	
■ Total Federal	\$ 35,200	
■ Plus Minnesota	\$ 17,440	(\$218K @ 8%)
■ Total Taxes	<hr/>	
	\$ 52,640	Fed & State

Cash Consequence (A)

■ Sale Price	\$240,000	
Less Commission	-12,000	(5%)
Less Other Costs	-5,000	
	<hr/>	
■ Net Cash	\$223,000	Available
■ Less Loan Payoff	-195,000	
	<hr/>	
■ Cash Proceeds	\$ 28,000	(at Closing)
■ Less Taxes	- 52,640	(due April 15 th)
	<hr/>	
■ Cash Shortfall	\$ 24,640	(on this Sale)

Still Happy & Content



- Investor pulled out net cash from the Duplex of \$170,000 from refinancing loans over the years.
- Investor also realized some positive cash flows from rental operations over the years.
- Life is still good

Scenario B: Assumptions

- Same facts as in Scenario A, except that there is a downturn in the market and the property sells on 12/31/2007 for only \$210,000 instead of \$240,000
- Balance of Loan Payoff at Closing is still the same at \$195,000
- NOW WHAT HAPPENS

Tax Consequence (B)

■ Sale Price	\$210,000	
Less Commission	10,500	(5%)
Other Costs	5,000	
■ Net Sales Price	<hr/>	
	\$194,500	
■ Less Tax Basis	5,000	(\$30K - \$25K)
■ LT Capital Gain	<hr/>	
	\$189,500	
■ Total Tax	\$ 46,085	Fed & State

Tax Calculation (B)

■ Depreciation	\$ 6,250	Recaptured
(\$25,000 @ 25%)		
■ L/T Cap Gain	24,675	(189.5K-25K)
(\$164,500 @ 15%)		
■ Total Federal	\$ 30,925	
■ Plus Minnesota	\$ 15,160	(\$189.5K @ 8%)
■ Total Taxes	\$ 46,085	Fed & State

Cash Consequence (B)

■ Sale Price	\$210,000	
Less Commission	-10,500	(5%)
Less Other Costs	-5,000	
	<hr/>	
■ Net Cash	\$194,500	Available
■ Less Loan Payoff	-195,000	
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■ Cash Shortfall	\$ 500	(at Closing)
■ Less Taxes	- 46,085	(due April 15 th)
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■ Cash Shortfall	\$ 46,585	(on this Sale)

Our Investor is Very Unhappy



- Investor still pulled out net cash from the Duplex of \$170,000 from refinancing loans over the years.
- Investor still realized some positive cash flows from operations over the years.
- But Investor is unhappy because he did not plan for the cash shortfalls.

It Could Have Been Worse



- What if the Sales price were \$200,000 instead of \$210,000?
- What if the Sales price were only \$190,000 (remember the loan pay-off to the bank was \$195,000).
- When selling Rental Property:
Cash is NOT the same as Tax
- Maybe consider an IRC Sec. 1031 Exchange to ease the tax burden and cash consequences.

Tax Planning is Important

- Be aware of Tax vs Cash Consequences
- Your Tax basis generally decreases (due to depreciation) while market values generally increase over time.
- FMV is used for loan refinancing, not tax basis.
- Cash is not the same as “Income” for tax purposes
- Set aside enough Cash to pay the Tax
- Consider some Tax Planning advice if your selling Rental Property that has been held for a long term.

The background of the slide features a pattern of stylized autumn leaves in various shades of brown and orange, set against a darker brown gradient background.

Thank You

**For more information
please contact**

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