

Capital Gains & 1031 Exchanges

What you need to know

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 high tax rates.

Fortunately, IRC Section 1031, a provision in the tax code since 1921, provides critically needed tax relief. 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 §1031.



Single Taxpayer	Married Filing Jointly	Depreciation Recapture Tax*	Capital Gains Tax Rate	Medicare Surtax**	Applicable State Capital Gains Tax
\$ 0 - \$ 49,450	\$ 0 - \$98,900	25%	15%		
\$49,451 - \$545,500	\$98,901 - \$613,700	25%	15%		
Over \$545,000	Over \$613,700	25%	20%		
MAGI over \$200 K	MAGI over \$250 K			3.80%	
					0 – 13.30 %

- * Depreciation Recapture on total depreciation taken on the business or investment real estate taken to date.
- ** Medicare Surtax (Net Investment Income Tax) based on modified adjusted gross income (MAGI)

- 1. Depreciation Recapture:** First, taxpayers will be taxed the depreciation recapture at rate of 25% on the total depreciation taken to date.
- 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 \$533,400 taxable income threshold for single filers and married couples filing jointly with over \$600,051 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. Medicare Surtax-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, annuities, royalties and passive rental and business income, (as well as other forms of “unearned income”).
- 4. State Taxes:** Last, taxpayers must also consider 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 allows taxpayers holding property for investment purposes to defer taxes that would otherwise be recognized upon the sale of investment property.