

How to Minimize Income Tax When Selling Real Estate at a Gain - South Florida Business Journal

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It seems that lately everyone is selling their real estate properties at a higher price than they purchased them for, yet not all transactions are being evaluated from a tax perspective beforehand. I always encourage my clients to call me to discuss, prior to listing or selling, so that we can plan for and factor in the tax implications. Below, I have outlined a brief summary of some of the items to keep in mind from a tax perspective when considering the sale of your real estate.



Tax tips according to real estate category

1. Sale of principal residence exclusion

Individual taxpayers may exclude up to \$250,000 and married individuals filing a joint return may exclude up to \$500,000 of gain on the sale of their personal residence, provided certain criteria are met. This is where the ownership and use tests come in.

The ownership test requires a taxpayer to own the home for at least two of the last five years, ending on the sale date. For a married couple, only one spouse needs to meet the ownership test. The use test requires the taxpayer to use the home as a principal residence for at least two years, which can fall anywhere within the prior five-year period. Both spouses must meet the use test to take advantage of the full \$500,000 exclusion.

This gain exclusion may only be taken once in a two-year period. A property that has been acquired through a like-kind exchange during the prior five years does not qualify. Don't forget to include the cost of any additions and improvements that have a useful life greater than a year, and settlement costs in the cost basis. This will help reduce any tax due.

2. Sale of rental property, commercial buildings or vacant land

When a client tells me they are thinking of selling one of these assets, the first question I ask is if they are considering purchasing a replacement property. This is when a tax mitigation strategy known as a 1031, or like-kind exchange, can be of great benefit. It allows taxpayers to exchange their real property (buildings and land) for other real property of equal or higher value and defer paying capital gains tax on gains from the sale.

Timing is important when implementing this strategy. The IRS requires taxpayers to identify a replacement property within 45 days of sale and the acquisition must be completed within 180 days. Taxpayers must work with a qualified intermediary to facilitate the exchange. A qualified intermediary will hold the funds from the sale

and transfer them, when the replacement property is selected, to the title or escrow company to purchase the replacement property. They will then convey title to the taxpayer by deed and keep complete records of the transactions.

It is important to note, however, that primary residences, second homes and vacation homes do not qualify for like-kind exchange.

3. Sale of a second home

The gain exclusion afforded principal residences and like-kind exchange rules afforded to real investment property are not available to offset gains on the sale of second or vacation homes. However, making sure you consider the costs of property improvements, property additions and settlement fees will help reduce tax.

Taxpayers may want to consider conversion. Converting a second home into a rental property or primary residence can make the two tax mitigation strategies outlined above viable options, assuming the market stays strong and the economic gain remains.

Conclusion

There are many other ways to mitigate or offset tax as part of your financial planning, but these decisions are best made with consideration of your entire financial picture. It is best to consult with an experienced advisor to discuss how you might leverage these or other strategies (such as gifting or examining depreciated assets) to achieve a better tax position that also complements your unique financial goals and priorities.

The information provided here is not investment, tax or financial advice. You should consult with a licensed professional for advice concerning your specific situation.