

Tax Pros Take on the Challenge of Big Write-Downs on Troubled New York Properties

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Rob Gilman leads the real estate practice at accounting and advising firm Anchin. Gilman lays out the scenario of a commercial building purchased for \$30 million with \$24 million in debt and \$6 million of equity, which is eventually sold for \$25 million.

“You ended up paying the \$24 million debt, and the equity investors have a \$6 million tax loss,” said Gilman.

But now reimagine that scenario to include \$10 million in depreciation taken since the purchase.

“The tax capital is now negative \$4 million,” said Gilman. “I still have money to pay the debt, but now I have a recapture because I ended up taking more write-offs than what I put in. An investor is going to have a \$4 million pickup of income.”

This will leave the seller with taxable income even though they’ve sold the property at a loss.

Then Gilman alters the scenario again, this time imagining the building sold for only \$20 million, leaving the seller without enough money to fully pay the debt.

“Now you have a potential pickup of \$4 million of cancellation of debt income,” said Gilman. “In certain situations, they’re going to have to pay taxes on that income.”

According to the IRS, “If your debt is canceled, forgiven, or discharged for less than the amount owed, the amount of the canceled debt is taxable,” with certain exceptions. “If taxable, you must report the canceled debt on your tax return for the year in which the cancellation occurred.”

“If you put \$6 million into a deal, over the life of the deal, what was your return? How much cash did you actually get back?” said Gilman. “Let’s just say you got zero cash back. At the end of the day, I know I have a \$6 million loss. But, if I took losses of \$10 million in the past, then I may have to pick up \$4 million of income. But my net number is going to be \$6 million. It can’t be anything different from an investor standpoint. On the flip side, the building might have been generating income, and I might have gotten \$2 million back. Well, now I know I’m going to have a \$4 million net loss, because I’ve gotten back two of my six.”

So, when Gilman’s clients ask him for projections of losses or gains after a building’s sale, he directs them to consider the losses and gains associated with the investment over the complete history of their ownership or investment.

“Investors will come to me, they’re selling a building at a big loss, and they want to know, ‘What should I project? Am I going to owe money? How big’s my loss going to be?’ And I’m like, ‘You may not have a loss. You may have income,’ ” said Gilman. “The way I tell them to look at it is, go back and say, ‘How much money did I put in? How much money have I received?’ That’s your global loss or income.”

When dealing with the sale of a building, then, at what seems like a loss in today’s market, it’s important to remember that determining losses and gains might be more complex than it appears, and that the only way to know for sure is to examine your complete financial history associated with the property.

“You have to look at your entire history from day one,” said Gilman.