

## Computing Capital Gains Income – Commercial Property

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### Computing Capital Gains A Three Step Process

- Step One: Determining the Cost Basis of Property
- Step Two: Determining the Adjusted Sale Price
- Step Three: Computing Capital Gain

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### Computing Capital Gain

**Depreciation - An accounting term used to describe the decline in usefulness of a company's tangible assets .**

**(27.5 Year Residential, 39 Years Commercial)**

**$\$500,000 / 27.5 = \$18,181$  (Excludes Land Value)**

**$\$18,181 \times \text{Five Years} = \$90,905$**

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## Computing Capital Gain

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- Step One: Determining the Cost Basis of Improvements

Original Cost <u>Basis</u> ( <i>Improvements</i> <b>27.5 Year Residential</b> )	
+Cost to Purchase	
+Capital Improvements	
-Depreciation Taken	$1 \div 27.5 = .0363$
<u>=Adjusted Cost Basis</u>	$.0363 \times \text{Five Years} = .181$

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## Computing Capital Gain

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- Step One: Determining the Cost Basis of Improvements

Original Cost <u>Basis</u> ( <i>Improvements</i> <b>\$500,000</b> )	
+Cost to Purchase ( <b>\$10,000</b> )	
+Capital Improvements ( <b>\$20,000</b> )	
-Depreciation Taken ( <b>\$90,905</b> )	$\$500,000 \times .0363 = \$18,181 \times 5 \text{ (years)} = \$90,905$
<u>=Adjusted Cost Basis</u> ( <b>\$439,095</b> )	

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## Computing Capital Gain

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- Step Two: Determining the Adjusted Sales Price

Sales Price ( <b>\$750,000</b> )	
-Cost to Sell ( <b>\$75,000</b> )	
<u>=Adjusted Sales Price</u> ( <b>\$675,000</b> )	

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## Computing Capital Gain

- Step Three: Computing Capital Gain  
Adjusted Sales Price **(\$675,000)**  
-Adjusted Cost Basis **(\$ 439,095)**  
=Capital Gain **(\$235,905)**
- Taxpayer would pay tax on recapture of Depreciation
  - 25% (IRS recapture rate) \$90,905= \$22,726 and
  - on the Gain 15% (IRS capital gain rate) x \$235,905= \$35,386
- \$22,726+ \$35,386= \$58,112 X Your Personal Tax Bracket Rate...

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## 2013 Income Tax Brackets

Rate	Single Filers	Married Joint Filers	Head of Household Filers
10%	\$0 to \$8,925	\$0 to \$17,850	\$0 to \$12,750
15%	\$8,925 to \$36,250	\$17,850 to \$72,500	\$12,750 to \$48,600
25%	\$36,250 to \$87,850	\$72,500 to \$146,400	\$48,600 to \$125,450
28%	\$87,850 to \$183,250	\$146,400 to \$223,050	\$125,450 to \$203,150
33%	\$183,250 to \$398,350	\$223,050 to \$398,350	\$203,150 to \$398,350
35%	\$398,350 to \$400,000	\$398,350 to \$450,000	\$398,350 to \$425,000
39.60%	\$400,000 and up	\$450,000 and up	\$425,000 and up

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## Deferring Capital Gain

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## Advantages of Real Estate

- Tax Treatment
  - 1031 Exchange

**“No gain ..... shall be recognized ..... if .... property is exchanged solely for property of *like kind* .....”**

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## Disadvantages of Real Estate

- Not Liquid
- Requires Management
- Large Dollar Amounts
- Immobility (Fixed Location)

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