Horizon
LAND SERVICES

1031Exchanges and the Recent Tax Rate Extension

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What Does This Mean for Real Estate Investors?

The December 2010 tax cut extension maintains President Bush-era tax cuts and provides new certainty for estate and tax planning- at least for the next two years. So what does this mean for investors and real estate brokers who want to help clients improve investment returns?

Income Taxes and Capital Gain Taxes- 2011/2012

The lower federal income tax rates applicable in 2010 that were set to expire on December 31, 2011, have been extended another two years. Similarly, capital gains tax rates will remain at a maximum tax rate of 15% over the same period. Prior to the extension, some real estate investors may have remained cautiously on the sidelines given the uncertainty as to future tax rates. Now is the time to get involved!

With the temporary extension of the Bush tax cuts, investors have greater certainty and should be more willing to participate in the improving real estate market. Indeed, some economists are saying that real estate values have already bottomed out making this the ideal time for real estate investors to jump back into the market. While current real estate prices may not have risen as much as sellers would prefer, a tax deferred exchange can alleviate the tax burden on sale and permit the seller to capitalize on the tremendous buying opportunities that exist in today's real estate market. Moreover, historically low mortgage rates provide an opportunity to lock-in low financing costs and improved cash flow as rents begin to rise. On the flip side, a seller continues to face low capital gain tax rates for at least the next two years if no suitable replacement property is acquired to complete a tax deferred exchange.

Estate Taxes 2011/2012

Prior to the tax cut extension, estate taxes were also a significant concern for investors and advisors. Fortunately, the tax cut extension established a federal state tax exemption of $5 million and a lower maximum tax rate of 35% had the extension not been passed, the exemption would have been only $1 million and the top rate would have been 55%! The extension also restored the step-up in basis that occurs on the owner's death that applied under prior law. With the return of the basis step-up rules, investors can effectively bypass paying capital gain taxes altogether. Given the higher estate tax exemption (a married couple can now pass up to $10,000,000 to heirs free of estate tax), the new estate tax rules have given investors an increased potential to turn a tax deferred exchange into a tax- free scenario.

To recap, with the extension of the Bush-era tax cuts:

A. By properly using 1031 exchanges, investors can never pay capital gain taxes on the exchange of properties held for investment.

B. As an estate planning strategy, heirs will inherit property with a full step in basis and without federal estate taxes up to the $5 million estate tax threshold.

C. The combined benefit: Never pay capital gain taxes and never pay estate taxes.

D. Call Asset Preservation, the leading national resource for 1031 exchanges, to learn more.