

# A SALE VS. AN EXCHANGE

## "ANALYZE THE BENEFITS BEFORE SELLING"



### Compliments of

The benefits of IRC Section 1031 exchanges can be tremendous! Investors are often able to defer thousands of dollars in capital gain taxes, both at federal and state levels. If the requirements of a valid §1031 exchange are met, capital gain recognition will be deferred until the taxpayer chooses to recognize it. This essentially results in a long-term, interest-free loan from the IRS.

### AN EXAMPLE

An investment property owner sells a rental property for \$400,000. The owner originally purchased the property for \$200,000. There is \$200,000 of debt and the property has been fully depreciated. The capital gain is approximately \$350,000 (assuming 75% of the property is depreciable). If the investor does not do an exchange, federal capital gain taxes would be:

|  |                 |
|--|-----------------|
| \$150,000 (depreciation recapture) x 25% = | \$37,500        |
| \$200,000 (capital gain balance) x 15% =   | \$30,000        |
| <b>\$350,000 Capital Gain Taxes Owed</b>   | <b>\$67,500</b> |

The state taxes owed (where applicable) would need to be added to the federal taxes due. Assuming the property owner sold in California, the following additional taxes would need to be paid:

|  |                  |
|--|------------------|
| State level (CA) 9.3%, \$350,000 x 9.3% =          | <u>\$32,550</u>  |
| <b>Total Capital Gain Taxes (Fed. &amp; State)</b> | <b>\$100,050</b> |

The next comparison analyzes the value of the new property that could be acquired in a sale versus an exchange. The comparison assumes an investor makes a 25% down payment and finances 75% of the property (75% loan-to-value ratio).

### SALE VS. AN EXCHANGE

|                                     | <u>SALE</u> | <u>EXCHANGE</u> |
|-------------------------------------|-------------|-----------------|
| Equity                              | \$200,000   | \$200,000       |
| Capital Gain Tax                    | \$100,050   | \$0             |
| Cash to Reinvest                    | \$99,950    | \$200,000       |
| <b>ASSUMING A 75% LOAN-TO-VALUE</b> |             |                 |
| New Property                        | \$399,800   | \$800,000       |

This example illustrates that the real power of a tax deferred exchange is not just the tax savings – it is the increase in purchasing power generated by this tax savings!

### ADVANTAGES OF AN EXCHANGE

1. Preservation of equity
2. Maximize return on investment
3. Increased cash flow from larger properties



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Template # 1

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