



Real Estate

-2013-

Tax and Business Update

Cape Coral Accounting Service LLC
3501 Del Prado Blvd S Ste 212
Cape Coral, FL 33904
239-542-2558

Real Estate Depreciation Rules

Generally, buildings and their structural components used in a trade or business or for the production of income are depreciated straight line (SL) over the following recovery periods:

- Nonresidential property—39 years.
- Residential rental property—27.5 years.

Exception: For assets placed in service in 2013, the following rules apply:

- *Qualified leasehold improvements* are depreciated SL over 15 years. They are also eligible for up to \$250,000 of Section 179 expensing and the 50% special depreciation allowance.
- *Qualified restaurant property and qualified retail improvement property* are depreciated SL over 15 years. They are also eligible for up to \$250,000 of Section 179 expensing but not for the 50% special depreciation allowance.

👁 **Observation:** Certain buildings used in specified activities (such as single-purpose agricultural structures or retail motor fuel outlets) are depreciated more quickly than the “normal” 39-year recovery period used for nonresidential property.

Land improvements (such as sidewalks and fences) are depreciated over a 15-year recovery period, using the 150% declining balance method.

Rental Real Estate

Most rental real estate is a passive activity. Generally, losses from passive activities can only offset income from other passive activities. *Exception:* Up to \$25,000 of rental real estate losses can be deducted annually if:

- 1) The taxpayer’s modified adjusted gross income is less than \$150,000 (\$100,00 if MFS).
- 2) The taxpayer actively participates in the rental activity. Active participation rules are met if the taxpayer:
 - Owns at least 10% of the rental property and
 - Has substantial involvement in managing the rental.

A limited partner cannot meet the active participation test.

The eligible loss is calculated by netting the income and losses from all of the rental real estate activities in which the taxpayer actively participates.

Special rules for real estate professionals. Real estate professionals can deduct rental real estate losses from rental activities in which they materially participate from their nonpassive income. A real estate professional is generally a person who meets the following requirements:

- 1) More than 50% of the individual’s personal services during the tax year are performed in real property trades or businesses in which he or she materially participates (work as an employee does not count unless the individual owns more than 5% of the employer) and
- 2) The individual spends more than 750 hours of service during the year in real property trades or businesses in which he or she materially participates.

Installment Sales

Under the installment method, a portion of the gain (but not a loss) from the sale of real property is reported as each payment is received.

- At least one payment must be received after the sale year.
- Not available to dealers in real or personal property or for the sale of securities.
- Not available for sale of depreciable property to a related person.
- Taxpayer can elect out of installment sale treatment.
- Gain attributable to depreciation recapture is recognized in year of sale.

Like-Kind Exchanges

Like-kind exchanges avoid current taxation when one property is replaced with like-kind property. *Ineligible property:* Inventory, partnership interests, securities, goodwill on going concern value business, entire businesses.

Tax deferral is mandatory if all requirements are met.

Requirements for like-kind exchange treatment:

- 1) Property is exchanged.
- 2) Both the property given up and the property received are held either for productive use in a trade or business or for investment purposes. **Note:** Although no specific holding period is required, generally the longer, the better.
- 3) The exchanged properties are like-kind.



Like-kind refers to the nature or character of the property, not to its grade or quality. U.S. real estate can be exchanged for other U.S. real estate. However, real property and personal property are not like-kind.

Examples of like-kind property.

- Improved and unimproved real estate.
- Water rights of unlimited duration and farmland.
- Owned real estate for leased real estate with a lease of 30 years or longer.
- Overriding royalty interest for overriding working interest in oil and gas property. (Working interest cannot be subject to liabilities or be partnership interest; royalties and working interests must be in the same tracts or parcels of land.)

Property that is not like-kind (including cash) is boot. Giving or receiving boot may trigger gain recognition.

The tax basis of property received in a like-kind exchange is computed as follows:

$$\begin{aligned} &\text{Adjusted basis of like-kind property given} \\ &+ \text{FMV of boot given (if any)} \\ &+ \text{Gain recognized on exchange (if any)} \\ &- \text{FMV of boot received (if any)} \\ \hline &= \text{Basis of like-kind property received} \end{aligned}$$

Notes

The information contained in this handout was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.

The handout is designed to provide accurate information regarding the subject matter covered. However, before completing any significant transactions based on the information contained herein, please contact us for advice on how the information applies in your specific situation.

© Copyright 2013