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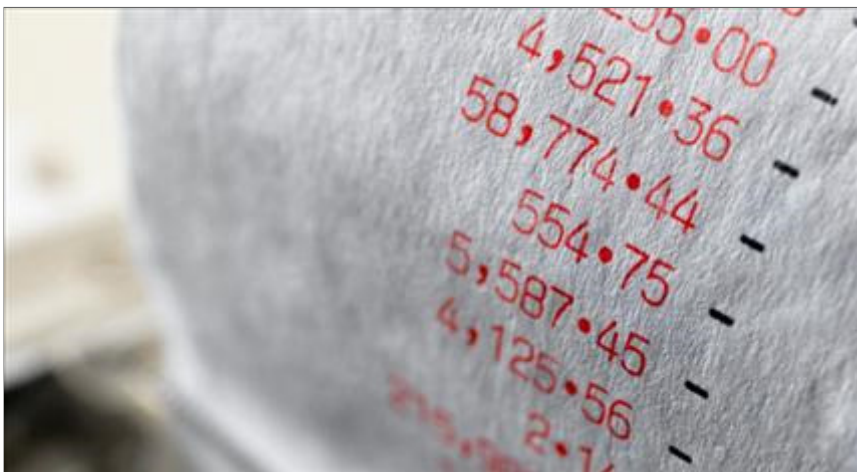
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Avoid tax pitfalls when selling a rental property

Capital gains tax and depreciation can dilute a homeowner's profit

By **Amy E. Buttell**, Cyberhomes Contributor
Published: November 11, 2009



Plan carefully for the tax consequences before putting a rental property up for sale. (Photo: iStockphoto)

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Whether you're a long-time landlord or new to the business of managing rental properties, there are lots of issues to consider when it comes time to place your rental property up for sale.

"Know the potential tax impact before you sell the property," advises

Karla K. Dennis, an enrolled agent and CEO of **Cohesive**, a tax advisory firm in Cypress, Calif. “Many people are looking to sell their property to secure additional cash. However, not understanding the full tax implications of the sale and how much you are going to have to fork over to Uncle Sam can be devastating come tax time.”

Here are the three most common questions — answered by industry experts — that landlords looking to sell their property may have about deciding to sell and the relevant tax consequences.

1. Will I have to pay capital gains taxes on my gains?

Yes, you have to pay federal capital gains taxes and you may have to pay state or local taxes, depending on where you live. For your federal taxes, the amount of tax depends on whether you lived in the property for two of the past five years and how much depreciation you took.

If you lived in the property for at least two of the past five years, you can exclude part of the gain based on the homeowner’s capital gain exclusion, says Abe Schneier, senior technical manager of taxation at the **American Institute of Certified Public Accountants** in Washington, D.C. If the property has been solely a rental for the past five years, you do not qualify.

Regardless of whether you lived in the house or not, you’ll be on the hook for depreciation recapture, because the tax benefit you received from depreciating your property on your taxes each year lowers your basis in the house and increases the amount of tax you’ll have to pay when you sell. “If you depreciated the property in prior years, the gain associated with depreciation will be taxed at a 25 percent rate,” says Dennis.


2. What expenses related to selling can I deduct?

“Whatever is on the closing statement would be deductible as part of the process of selling the house,” says Phil Liberatore, CPA, of **IRS Problem Solvers** in La Mirada, Calif. This includes any state or local transfer or selling taxes, legal fees, advertising expenses, Realtor’s commission and appraisal fees.

3. How do I figure out my basis when calculating if I have a gain?

It’s in your interest to have as high a basis as possible in your property to minimize potential taxes, says Dennis. “Start with whatever you paid for it based on the closing statement when you purchased the property,” says Schneier. While you can add improvements to the tax basis, you can’t add ordinary repairs that maintain the property. So if you put in a new kitchen, that’s an improvement that will increase your basis. But if you put on a new roof because the old roof was in dire need of repair, that doesn’t increase your basis. Make sure to keep receipts and document all your expenses, he adds.

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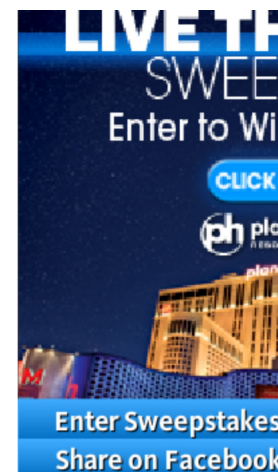
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