

Allocate Sales Price on Rental Property

By [Gina L. Gwozdz, CPA](#)

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Doris from CA writes:

Hi Gina,

Great blog! I have a question about allocating costs between land and buildings. We have a rental home that we sold this year. For the initial allocation between the land and building, I used the original property assessment for the home. (We originally purchased it as our main home and converted to a rental home 2 1/2 years later). Now that we've sold it, I'm not sure how to allocate the sales price between the two. Is there a general rule that accountants use to do this allocation? I've noticed that the county assessor's office uses about about 30% land, 70% building.

Thanks you in advance for your help!

Doris

My response:

Hello Doris. Thanks for your kind words about my blog.

The best way, in my opinion, to allocate the sales price would be based off of the appraisal that was done at closing. If you are ever audited the appraisal will help you greatly. This is why I always advise my clients to either pay for their own appraisal when they are selling a rental property (or commercial real estate) or offer to pay half of the appraisal price to the buyer in exchange for letting you receive a copy of it as well.

Short of an appraisal, the next best thing would probably be to view the most recent property tax statement vs. the one when the building was placed in service as a rental. Compare the amount that the land increased over those years (if it increased at the same rate as the building or more or less - since you're in CA I would guess the land appreciated way faster than the building). Use that as a guide to allocate the sales price between the land and the building. Please note that some appraisals are not routinely updated property to their fair market value, in which case this isn't a very good route to go. Another suggestion would be to talk to a local realtor or an appraiser and see if they can help you.

The "rule" that accountants use is Internal Revenue Code Section 1250 or specifically Regulation §1.1250-1(a)(6) which states in part, "...the total amount realized ... shall be allocated between the section 1250 property and the other property in proportion to their respective fair market values ... in accordance with the principles set forth in ... (Reg. §1.1245-1(a)(5))". In turn, Reg. §1.1245-1(a)(5) states: "... the total amount realized ... shall be allocated ... in proportion to their respective fair market values. In general, if a buyer and seller have adverse interests as to the allocation ... any arm's length agreement ... will establish the allocation. In the absence of such an agreement, the allocation shall be made by taking into account the appropriate facts and circumstances. Some (facts and circumstances) ... include ... (i) original cost and reproduction cost ... (ii) the remaining economic useful life, (iii) state of obsolescence, and (iv) anticipated expenditures to maintain, renovate, or to modernize."

Sale of rental property can quickly become complex, since you are usually dealing with three different kinds of property (§1250 property, §1231 property and §1245 property), which are handled differently upon sale. It is best to find a qualified tax professional to help you properly record your sale.

Gina L. Gwozdz is a CPA who has chosen to specialize in taxes. Visit her website at <http://GLGcpa.com> to view more Tax Tip Articles.