

# Sale of Rental Property

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## Megan asks:

I have rental property which I plan on selling. I'm estimating that I'll have about \$100K in profit. How will this affect me taxwise? I would also like to know if I should buy another property or use the money to pay down my mortgage. Any suggestions? Please respond.

Thanks in advance,  
Megan

## My response:

Hello Megan, thanks for writing.

I think it's excellent that you're asking these questions BEFORE you sell your rental. The problem is that these are questions that you should be discussing with your tax professional, because without knowing a lot more information (your age, whether or not you manage the property, your financial situation now and expected in the future, the state you live in, etc.), I really can't give you any specific advice and my general advice may not be appropriate for your situation.

If you're like my average client, you're probably mistaken on what your taxable profit in your rental is likely to be. Most taxpayers forget about adjustments to their basis and simply assume their selling price less what they initially paid for the property is their gain or loss. Not so. You should ask your tax professional to estimate your estimated tax liability on the sale of your rental.

If you've made any permanent improvements over the years since you purchased your rental property, these improvements will usually increase your basis. The largest deduction to your basis is usually depreciation, whether or not you claimed it. If you live in any of the disaster areas, you may have incurred a casualty loss that modified your basis. Your property may be subject to depreciation recapture, which would change the character of profit that you will have.

How much tax you will pay on the gain will depend on your particular situation. You may find that this gain has caused you to be in a high tax bracket. Your exemptions and deductions may be phased out. You may be unable to make a deductible IRA contribution. This may even put you in an AMT situation. The best thing to do is to sit down with your tax professional and have him or her help you plan this out.

After your tax professional has helped you figure out your potential profit and related tax liability, then it is time to consider you options. If you decide to purchase another rental property then the smartest tax method for this is called a [1031 exchange](#). You have to set this up BEFORE you sell your current rental, but once you do you can postpone paying tax on the gain from the sale. This is a complex transaction and should not be done with professional help.

If you decide to put your net profits into your home or into any other investment which would be considered personal in nature (stock market, savings account, etc.), you will need to make an estimated tax payment to the IRS and your state.

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**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.