Understanding Capital Gains Tax

A Quick Guide for Real Estate & Investment Sales

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What is Capital Gains Tax?

Capital gains tax applies when an asset is sold for more than its **adjusted basis** (purchase price plus certain costs). The tax rate depends on **how long the asset was held** and the **seller's income level.**

Capital Gains Tax on Real Estate

Real estate sales—whether **investment properties** or a **primary residence**—may trigger capital gains tax. However, there are tax strategies that can help reduce or defer the tax burden.

Key Factors Affecting Real Estate Capital Gains Tax

Factor	Impact on Capital Gains Tax
Holding Period	Properties held **over one year** qualify for **lower long-term capital gains tax rates** (0%, 15%, or 20%). Properties held **one year or less** are taxed at **ordinary income rates**.
Primary Residence Exclusion	Homeowners may **exclude up to $250,000 ($500,000 for married couples)** of capital gains if they meet ownership and residency requirements.
1031 Exchange (Deferral Option)	Investors can defer capital gains tax by reinvesting proceeds into another **like-kind investment property** through a **1031 exchange**.
Depreciation Recapture	If a rental or business property was depreciated, a portion of the gain is taxed at a **higher 25% rate**.

Capital Gains Tax Rates (2025)

Taxable Income (Single & Married Filing Separately)	Taxable Income (Married Filing Jointly & Qualifying Widow(er))	Long-Term Capital Gains Rate
$0 – $64,750	$0 – $129,500	0%
$64,751 – $566,700	$129,501 – $1,133,400	15%
Over $566,700	Over $1,133,400	20%

Short-term capital gains (for assets held one year or less) are taxed as ordinary income, with rates ranging from 10% to 37%.

Net Investment Income Tax (NIIT) of 3.8% applies to high earners with a Modified Adjusted Gross Income (MAGI) over $200,000 (single) or $250,000 (married filing jointly).

Depreciation Recapture on rental properties is taxed at a fixed 25% rate.

Case Study: Estimating Capital Gains Tax on a Real Estate Sale

- **Purchase Price:** $300,000
- **Improvements & Selling Costs:** $50,000
- **Adjusted Basis:** $350,000
- **Sale Price:** $600,000
- **Taxable Gain:** $600,000 - $350,000 = $250,000
- **Estimated Tax (if long-term at 15% rate):** $250,000 × 15% = $37,500

Tax Strategies for Real Estate Sales

1. Primary Residence Exclusion

» If you lived in the home for 2 of the past 5 years, you may exclude up to $250K ($500K for married couples) in capital gains.

» Partial exclusions apply for job relocation, health reasons, or other unforeseen circumstances.

2. 1031 Exchange – Tax Deferral for Investment Properties

» Reinvest proceeds into a like-kind property to defer capital gains tax.

» Must identify replacement property within 45 days and close within 180 days.

» Applies to investment properties only, not primary residences.

3. Increase Your Basis – Track Home Improvements

» The higher your adjusted basis, the lower your taxable gain.

» Eligible improvements: Additions, remodels, HVAC, roofing, plumbing, electrical

» Repairs & maintenance do not count toward basis.

4. Installment Sales – Spread Out Gains

» Sell property over multiple years to stay in a lower tax bracket.

» You pay tax only on the portion received each year.

» Not ideal if you need full proceeds upfront.

5. Strategic Tax Planning – Minimize Your Tax Liability

» Sell in a low-income year to reduce tax rates.

» Offset gains with losses (tax-loss harvesting).

» Consider estate planning – Inherited properties get a step-up in basis, reducing taxes.

» Some states tax capital gains separately, requiring additional planning.

Have Questions?

Not all property sales are taxed the same way. Factors like **how long you've owned the property, depreciation, and reinvestment options** can significantly impact your tax liability.

Let's talk strategy to ensure you're making **tax-efficient decisions** and keeping more of your profits.