Tax considerations of the disposition of property

When you transfer, sell or otherwise dispose of property, you may face tax consequences. Keep in mind these may be income tax consequences, as well as transfer tax consequences, such as gift and estate tax liabilities. The type of tax that may be due depends on whether the transfer was in the form of a sale, exchange, gift or bequest.

Sales
A sale is generally a rather straightforward concept. You own property but give up those ownership rights in return for other assets, usually cash. You may have either an “ordinary” or “capital” gain or loss upon the completion of the transaction. A capital gain or loss is one that occurs when a capital asset is sold. A capital asset is any property except:

- An inventory item
- Property held primarily for sale in the ordinary course of a trade or business
- Depreciable business property
- Real estate used in your trade or business
- A copyright, literary, musical or artistic composition held by its creator

Anything not characterized as a capital asset is an ordinary asset. The gain or loss can be either short term or long term, depending on how long you held the property before its sale. If the holding period was 12 months or less, then the gain or loss will be characterized as short term. If the holding period was for a period of more than 12 months, it will be treated as long term. This treatment may affect the tax due.

In determining the taxable amount, subtract the adjusted cost basis—the change in the asset’s value after improvements, payouts or other factors—from the fair market value (FMV), as of the date of the sale. You may be required to submit a professional appraisal to document the value. This difference may be subject to federal and state income tax.
When dealing with capital gains or losses, you must first determine all short-term and long-term gains and losses. Once you arrive at this “net” figure, you must offset net long-term gains with any net short-term losses. If there are remaining net long-term gains, then such income will be taxed as follows:

### 2021 Capital gains tax rates

<table>
<thead>
<tr>
<th>Long-term capital gains tax rate</th>
<th>Single</th>
<th>Married, filing jointly</th>
<th>Head of Household</th>
<th>Married, filing separately</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>$0 to $40,400</td>
<td>$0 to $80,800</td>
<td>$0 to $54,100</td>
<td>$0 to $40,400</td>
</tr>
<tr>
<td>15%</td>
<td>$40,401 to $445,850</td>
<td>$80,801 to $501,600</td>
<td>$54,101 to $473,750</td>
<td>$40,401 to $250,800</td>
</tr>
<tr>
<td>20%</td>
<td>$445,851 or more</td>
<td>$501,601 or more</td>
<td>$473,751 or more</td>
<td>$250,801 or more</td>
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</tbody>
</table>

*Short-term capital gains are taxed as ordinary income, but these tax brackets and rates will change.*

Depending on the amount of your net investment income, you may also be subject to a 3.8% Medicare surtax over and above the stated capital gains rates.

If you sell property on which you have taken any depreciation deductions, you may have to recapture that depreciation at the time of sale.

### Exchanges

When real property is held for productive use in a trade or business, or held for investment purposes is exchanged with, or traded for, other property of a like kind, there is generally no gain recognized. In such situations, the cost basis of the asset exchanged is substituted for the asset acquired and the holding period continues to run uninterrupted. For exchanges to be “like kind,” the assets must be of the same nature or character even though they may differ in grade or quality. For example, land with an apartment building exchanged for land with a store is considered an exchange of a like kind. Even improved land traded for unimproved land is treated as a like kind exchange. Domestic real estate exchanged for foreign real estate is, however, not a like kind exchange.

If you receive money or unlike property in an exchange of like kind property and you realize a gain, you may have a partially nontaxable exchange. You must recognize the gain, but only up to the fair market value of the unlike property you receive. The gain recognized on the property you give up is the lesser of the:

- Amount of gain realized, or
- Limit of gain to be recognized

For example, you trade investment property with an adjusted cost basis of $8,000 for other real estate with a fair market value of $10,000. In addition, you get $1,000 in cash. Your expenses in the transaction totaled $500. Your realized gain is $2,500 ($10,000 value of the property received plus $1,000 in cash less your $500 costs less your adjusted cost basis of $8,000). Your recognized gain is $500 ($1,000 cash received less your $500 costs).
Be aware that this may also apply to like kind exchanges between related persons, which includes:

- Members of the same family
- An individual and a corporation, if the individual owns more than 50% of the corporate stock
- The grantor and trustee of a trust
- A trustee and a trust beneficiary

If the property received in a like kind exchange is disposed of within two years of the date of the transfer that was part of the like kind exchange, there can be a disqualification of the nonrecognition treatment.

**Gifts**

Generally, giving away assets does not incur an income tax consequence to either the person making the gift or the person receiving the gift. If you sell property that you received as a gift, the same rules apply but your basis that is used to calculate the amount of your gain is a bit different because you did not purchase the asset. Your basis is calculated as if the asset was still in the hands of the donor; this is called “carryover basis.”

Example, you acquired shares of a stock for $500 and gave them to your brother as a gift. If he sells the shares when they reach $1,000 in value, the tax liability would be based on a $500 gain.

**Bequests**

Unlike a gift that has a carryover basis, property that you inherit has a “stepped up” basis. The basis is “stepped up” to either the fair market value of the property on the date of death of the person from whom you inherited or a date that is six months later, called the “alternate valuation date.” The latter is generally used only when an estate tax return has been filed. Note that retirement assets and other assets that would be considered income to the decedent will not receive a step up in basis.

One important exception to this “stepped-up basis” rule is if the beneficiary who receives the bequest is the same person who had—within one year of the decedent’s death—transferred the asset to the decedent. In this case, the beneficiary’s cost basis is the same as the decedent’s carried-over cost basis (i.e., the same as the cost basis that the beneficiary had in the asset, as of the date he or she gave the asset to the decedent).

**Getting help**

Disposing of assets can be a complex matter, involving a variety of potential tax consequences. It’s a good idea to discuss your plan with an experienced advisor. If you have questions about the tax consequences of selling, exchanging, gifting or bequeathing assets, you should contact your estate planning attorney or your accountant. Your TIAA advisor can help you think about selling, transferring or gifting assets in the context of your overall financial plan.