MARK DIMERCURIO · 1031 CAPITAL SOLUTIONS

CAPITAL GAINS · EXPLAINER

How Much Tax Will You Owe When You Sell a Rental?

The tax bomb, decoded: the four stacked pieces of the bill on an appreciated rental, the basis math that makes it bigger than you'd guess, how to estimate yours, and where a 1031 exchange can defer it.

Why this packet exists

When you sell a rental that has gone up in value, the tax bill is often bigger than owners expect — because it isn't one tax, it's up to **four** stacked on top of each other. People have a name for what they feel at the closing table: the **tax bomb**. This packet breaks each piece down plainly, so the fog clears and you can see the whole picture before you sell. None of this is tax advice — the numbers depend entirely on your situation, and your CPA should run the real figures.

It starts with your gain — and your basis

Everything is calculated on your **gain**, not your sale price: the sale price minus your *adjusted cost basis*. Adjusted basis is roughly what you paid, **plus** improvements you made, **minus** the depreciation you've claimed over the years. On a property held for decades, that gain can be most of the sale price.

This is the part that surprises people. The depreciation you deducted along the way *lowered* your basis — and a lower basis means a *larger* gain. So the deductions that felt like a gift while you owned the property quietly enlarge the tax when you sell. To put numbers on the mechanic: a property with an original **$500,000** basis, after years of depreciation, might carry an *adjusted* basis closer to **$318,000** — and the gain is measured against that smaller figure, not the original price.

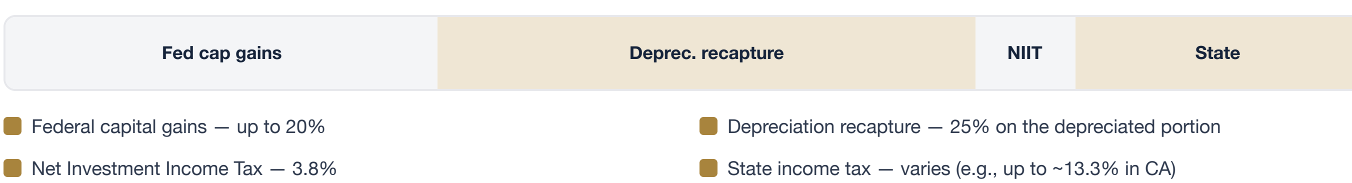
> All figures in this packet are **hypothetical / illustrative — individual results vary.** Only your CPA can compute your actual numbers.

The four pieces of the bill

- **Federal capital gains tax.** If you held the property more than a year, the gain is taxed at *long-term* rates (lower than ordinary income), up to roughly 20%; a year or less, it's taxed as ordinary income. The holding period matters a lot.
- **Depreciation recapture.** The depreciation you deducted gets "recaptured" at sale — taxed at a rate **up to 25%**. This is the piece that surprises people, because it applies even if the property barely appreciated.
- **Net investment income tax (NIIT).** An extra **3.8%** can apply to investment gains above certain income thresholds.
- **State income tax.** Your state may tax the gain too — anywhere from 0% to north of 13%, depending on where you live.

Add those together and the combined bite can reach well into the double digits as a share of your gain. That total is exactly the tax bomb owners are reacting to when they say selling "triggers" one.

The tax bite on a sale of appreciated rental real estate



Total: roughly 30–40% of your gain

Illustrative combined rates; your actual tax depends on your basis, income, and state — ask your CPA. Individual results vary.

A worked example

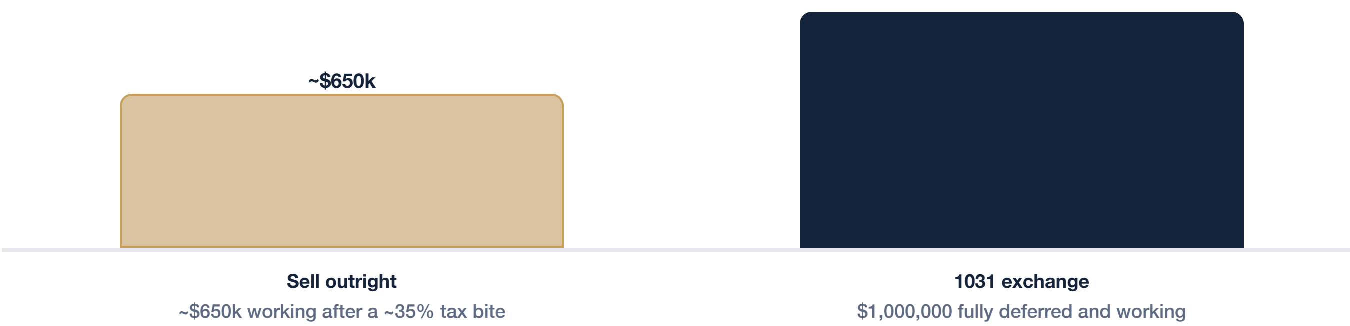
> **Hypothetical / illustrative — individual results vary.** Not a quote, not a projection, and not advice. They exist only to show how the four pieces stack. Your real figures depend on your basis, bracket, income, and state, and only your CPA can compute them.

Consider an investor who bought a Bay Area duplex decades ago for roughly **$220,000**. Today it's worth about **$1.7 million**. After years of depreciation, the adjusted basis is well below the purchase price, so nearly the entire $1.7M sale is gain. Now stack the bill:

Piece of the bill	Illustrative rate	Notes
Federal capital gains	up to ~20% on the appreciation portion	the largest slice for a long-held, highly appreciated property
Depreciation recapture	up to 25% on prior depreciation	applies to the depreciation that lowered the basis
Net investment income tax	3.8%	above certain income thresholds
State income tax	0% to north of 13%	California, for example, sits at the high end

Because the gain has to be divided between appreciation and recaptured depreciation — which are taxed at different rates — there's no single "headline" percentage. On a gain of this size in a high-tax state, the stacked total can **roughly** claim a meaningful slice of decades of equity. The takeaway isn't a number; it's that the *stack* is what makes the total larger than most people first guess.

The same $1,000,000 of equity, two ways



Illustrative 35% combined tax rate; a 1031 defers — does not eliminate — tax. Individual results vary.

Estimate yours in about a minute

The fastest way to see the order of magnitude for *your* sale is to run the numbers. The capital gains estimator at *markdimercurio.com/estimator* walks you through federal, recapture, NIIT, and state, and shows roughly what you'd owe — and what you'd keep. It's an educational estimate, not tax advice, but it's a useful gut-check before you talk to your CPA.

Where a 1031 exchange fits

If the bill gives you pause, a 1031 exchange lets eligible investors **defer** — not eliminate — capital gains and depreciation-recapture tax (and the NIIT and state pieces along with them) by reinvesting the proceeds into other like-kind investment real estate within strict IRS deadlines. Deferring the whole stack is what keeps your **full equity working** instead of sending a slice to the IRS at the moment of sale.

One replacement option is a **Delaware Statutory Trust (DST)**, which lets you stay invested passively — moving from *active* landlording to a *passive*, professionally managed interest. DSTs are securities, available only to accredited investors, offered solely through a sponsor's PPM, and they're illiquid, fee-bearing, and carry risk including loss of principal. **Distributions are not guaranteed** — they aren't right for everyone.

The honest caveats

- **It's an estimate.** Brackets, exclusions, AMT, and the full shape of your return all move the real number — only your CPA can compute it.
- **Defer is not eliminate.** A 1031 pushes the tax down the road; whether and when it comes due depends on your future decisions (and, in some cases, a step-up in basis at death — a question for your advisors).
- **Plan before you sell.** A 1031 has to be set up *before* the sale closes — once you've taken the proceeds, the door is shut.
- **No two situations match.** The illustration above is a teaching tool, not your number.

A soft next step

The honest order of operations is: estimate the order of magnitude, then sit down with your CPA for the real figure, then — if deferral is something you want to understand — talk through the options. A complimentary, no-pressure educational call is available whenever it would help, with no obligation.

Education only. This packet is not tax, legal, or investment advice, and it is not an offer to buy or sell any security. Please consult your own advisors.

The number that catches almost everyone off guard is depreciation recapture — those deductions felt like a gift while you owned the property, and the IRS quietly remembers them at the sale. That's not a reason to panic; it's a reason to run the real math early, with your CPA, before you've signed anything. I'd always rather you walk in with clear eyes than be surprised at the closing table.

Mark DiMercurio
Senior Vice President of Investments · 1031 Capital Solutions
(442) 255-3535 · mark@1031capitalsolutions.com
markdimercurio.com