

Welcome to **Realtors Resource Letter** — a periodic publication that identifies and explains current key tax and finance issues pertinent to professionals dealing in real estate and to their customers.

INSIDE:

- Tax benefits of Investment Real Estate
- Who Qualifies as a Real Estate Professional?
- Code Section 1031 Tax Deferred Exchanges of Real Estate
- Sales of Primary Residences

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About Brinker, Simpson & Company

Brinker Simpson & Company, L.L.P. has been the leading tax, financial and business authority for our clients for more than 20 years. We know that professionals dealing in real estate have unique goals and needs when it comes to creating success through related tax, financial and business planning. We offer real estate professionals the type of tax and business guidance that can only come with experience. We bring that experience — and use it to keep our clients current on the latest trends and issues.

Free Consultation

Contact Brinker Simpson & Company, L.L.P. to arrange for a complimentary consultation on any of the topics listed in Realtor Resource Newsletter and any other real estate tax or finance matters of concern. Call (610) 544-5900 or e-mail us at info@brinkersimpson.com. You can also visit us online at www.brinkersimpson.com.

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RealtorsResourceLetter

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Welcome
from **Bob
Simpson,**
MS, CPA

Dear Reader:

Welcome to Realtors Resource Letter — a periodic publication that identifies and explains current key tax and finance issues pertinent to professionals dealing in real estate and to their customers.

This report is published by Brinker Simpson & Company, L.L.P., a certified public accounting and business advisory firm that has been a leading authority advising clients on real estate tax issues for more than 20 years, whether they have basic tax needs or require highly complex accounting, tax and financial planning advice.

We are a full service accounting and tax firm specializing in small business issues and individual income tax planning.

We welcome your comments, and ask that you request additional copies of Realtors Resource Letter for your customers and colleagues. We can be reached at (610) 544-5900 or rsimpson@brinkersimpson.com.

*Sincerely,
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SALES OF PRIMARY RESIDENCES

In 1997, Congress passed the Taxpayer Relief Act, and with it, the tax burden on the sale of primary residences was eased for millions of taxpayers. The “old rules” allowed taxpayers over age 55 to exclude \$125,000 in profits on the sale of their home. But, the new rules dramatically expand the exclusions, and remove the age brackets. Now, in most cases, you can make tax-free profits of \$250,000 (single taxpayers) and \$500,000 (joint taxpayers)...and there is no limit on the amount of times you use the exemption... and there is no requirement that you reinvest the proceeds into another residence. *(continued on next page)*

CODE SECTION 1031 – TAX DEFERRED EXCHANGES OF REAL ESTATE

Tax deferred exchanging (Code Section 1031) is an investment and tax saving strategy that should be CONSIDERED by everyone who owns investment real estate. The exchange is simply a method by which a property owner “trades” one property for another like kind property without having to pay federal income taxes on the transaction. In an ordinary sale, the taxpayer pays tax on the gain recognized on the transaction. But in an exchange, the tax due on the transaction is “deferred” until some time in the future, usually when the newly acquired property is sold. Even though you often hear of these transactions as “tax free exchanges”, the tax is actually DEFERRED TO A LATER DATE.

The regulations in Section 1031 are complicated, but here are the basic specifications for a valid exchange:

- Real estate must have been held for investment or in a trade or business...both the property sold, and the property purchased.
- Replacement property must be “like kind” to the property being relinquished. All real property is like kind, and one property may be exchanged for multiple properties.
- A rule of thumb: the property must have been held for one year before it is eligible for exchange (since property held for resale does not qualify for the exchange, the holding period is a flexible issue).
- A true exchange must take place. You cannot sell a property then purchase another one and declare it as a 1031 exchange.
- Seller has 180 days after relinquishing the initial property to complete the exchange for another property. You must identify three qualified properties within 45 days of the transfer of the original property, and must complete the exchange with one (or more) of those properties within the 180 days.

With the recent run up in real estate values, it would be beneficial to consider a 1031 exchange for the sale of your investment properties.

See inside for valuable information on tax benefits of investment real estate, who qualifies as a real estate professional, and more!

SALES OF PRIMARY RESIDENCES (CONTINUED FROM PAGE 1)

In order to qualify, some parameters must be met:

- The property must be your “primary” residence, and the IRS has issued regulations on what qualifies as a primary residence, for multiple residence homeowners.
- The home must have been the primary residence for two of the last five years preceding the sale.
- There could not have been an exclusion of another home sale within 2 years of this sale.

Regulations enacted this year allow for a partial exclusion in certain situations where the sale occurs before the two year period is satisfied, if the sale is due to change in employment, health reasons, or unforeseen circumstances.

This is one of the few areas of “tax free income” and needs to be considered when selling a home.

CLIENT COMMENTS

“I have been associated with the staff at Brinker Simpson & Company for a number of years and found them to exhibit a high degree of professionalism and competency while serving their clients. As a Commercial Lender/Business Banker of a local bank, I feel very comfortable in referring my customers to the firm, because I know their needs will be met, and I know they bring a depth of knowledge and experience needed by small and mid-sized businesses.”

—Vice President of Commercial Lending for a Local Bank

“As a client of the firm for twelve plus years, Brinker, Simpson & Company, L.L.P. has continued to extend its services to me on both a personal and professional level as my companies have grown. Brinker Simpson & Company, L.L.P. provides the expertise of a large accounting firm but hasn't forgotten its small business roots.”

—President of a multi-location Property/Casualty Insurance Agency

SALES OF SECOND HOMES – “NON PRIMARY” RESIDENCES

Unlike the sale of your primary residence, there is no tax free exemption on the sale of your second, or vacation homes. These homes are treated as personal assets, and any gain realized on the sale would be included as capital gain income, and taxed accordingly in the year of sale.

Losses on the sale of these homes are NOT DEDUCTIBLE against other income. Many taxpayers believe you can exclude the tax on a gain of a vacation home, if they “reinvest” the proceeds into another home of equal or greater value. THIS IS NOT CORRECT, the reinvestment of the proceeds does not impact the taxation of the gain on the home sold.

Additional copies of Realtors Resource Newsletter are available. You may request copies for your customers and colleagues.

Contact H. Leese at (610) 544-5900 or info@brinkersimpson.com

TAX BENEFITS OF INVESTMENT REAL ESTATE

Many taxpayers have purchased real estate for investment purposes (rented or developed). When all costs, including property depreciation, are included, many rental properties reflect losses for tax purposes. These losses are considered “passive” and can be used to offset other income on the taxpayers returns in CERTAIN CIRCUMSTANCES.

- Rental activity must be an active pursuit, with active management.
- Losses are limited to a maximum current year deduction of \$25,000 (for taxpayers with income below \$110,000).
- Losses are phased out (available to be carried over to a subsequent tax year) when the taxpayers income exceeds \$110,000 to \$160,000.
- Real Estate professionals are exempt from the income limitations, and the loss limits.

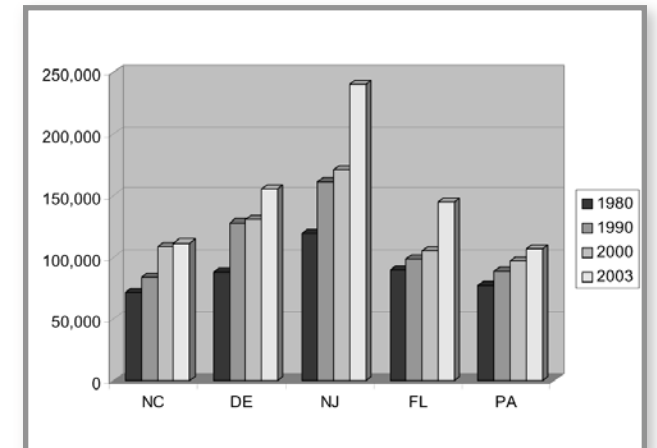

Losses that are not currently deducted are not forgotten. They are carried over to the next tax year, and then the criteria are measured again. Any losses that have not been used, will be available when the property is sold, and can be deducted in that tax year.

For the personalized attention and real estate knowledge you need...and deserve, contact Brinker Simpson & Company, L.L.P., (610) 544-5900.

MEDIAN HOME VALUES OVER 60 YEARS

According to the U.S. Census Bureau, median home values adjusted for inflation nearly quadrupled over the 60-year period since the first housing census in 1940. The median value of single-family homes in the United States rose from \$30,600 in 1940 to \$199,600 in 2000.

The chart at right shows median home values for North Carolina, Delaware, New Jersey, Florida and Pennsylvania from 1980 through 2003 (when the last housing census was taken country-wide).

“...median home values adjusted for inflation nearly quadrupled over the 60 year period since the first housing census in 1940.”

DEPRECIATION AND RECAPTURE

As real estate investors are aware, depreciation reduces your “basis” in the property, and is deductible ratably over the life of the property. The basis is used to figure the gain or loss when the property is sold, and you will be required to RECAPTURE the depreciation.

Depreciating real estate can produce tax write offs, but when the property is sold, this deduction will come back to haunt the seller as an additional gain on the sale of the property.

Special note — the tax rate on depreciation recapture can be significantly higher than the capital gain rate on the sale of the property.



If you would like copies of this newsletter FREE, for your customers or colleagues, contact H. Leese by phone (610) 544-5900 or e-mail at hleese@brinkersimpson.com.

WHO QUALIFIES AS A REAL ESTATE PROFESSIONAL?

Certain “real estate professionals” may be able to treat rental real estate activities as “non-passive”.

To qualify:

- 1) More than half of the services performed by the taxpayer in business must involve real estate and be a business of material participation by the taxpayer or spouse AND
- 2) The taxpayer must perform more than 750 hours of service during a tax year in real estate business.

A real estate trade or business is a business with respect to which real property is:

- developed
- rehabbed
- reconstructed
- acquired
- converted
- constructed
- rented
- leased
- managed
- sold or brokered

Certain passive loss limitations do not apply to real estate professionals.