By Phil Hunt

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Q: We are preparing our property for sale, and there is a lot of work to do to get it ready. It needs carpet, paint, roof, yard work… and lots more. I am wondering if any of the fix-up expenses are deductible from our taxes.

A: I am neither an accountant, nor a tax preparer and can not give tax advice. But I have learned a few details about taxes over the years. Taxes are not only a necessity, they are a privilege, or so I have been told by my "bean counter" (accountant).

It has always been an assumption that fix-up expenses involved in the preparation of a property for market are deductible in the form of raising the basis of the property. Basis is the price paid for the property at time of purchase plus all major improvement expenses during the period of ownership.

Profit is the difference between the basis and the selling price.

In today's world of taxes, every residential property owner who lives in the property, two out of the past five years, gets an automatic $250,000 deduction from profit ($500,000 for a married couple). With this deduction, most taxes are wiped out automatically. So, the actual expense of the fix-up will probably be lost.

If it were a commercial income property, however, the fix-up costs are deductible because the automatic deductions, $250,000 or $500,000, are not applicable to income property. In this case, you would see the deduction against the profit.

If you were doing a 1031 tax-deferred exchange, however, the benefit would be deferred because the profit is deferred until such time as you sell the last 1031 property and do not trade it up to another income property.

And, if you die, your heirs would inherit the property and there would be no taxes due if the property were sold at the appraised value, as of the date of death.

Here is an example of how 1031 tax benefits work, provided it is done within the rules of the 1031 tax-deferred exchange: A buyer purchases property “A” for $300,000, sells it for $500,000 and trades up into property “B,” priced at $700,000 — no taxes are due; the buyer then sells property “B” for $1,000,000 and trades up into property “C” for $1,500,000 — still no taxes are due; the buyer then sells property “C” for $2,000,000 and trades up to property “D” for $3,000,000. All of the deferred profit amounts to $1,000,000. Now, the owner dies. The appraised value at the date of death is $4,000,000. If the heirs sell the property for $4,000,000 there will be no taxes due. What a deal, the heirs just captured $4,000,000 tax free, the owner just has to die to make it happen.

There are other deferrals available, but those should be discussed with a tax accountant. Thanks for the question.

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