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OPINION

Today's Business: Transferring appreciated property can have a major tax impact

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With the value of your home increasing substantially, perhaps you need to take a fresh look at your estate plan.

As has been widely reported, home values are on the rise. This is a hoped for and desired result when you purchase a home. You want the value to go up and, in fact, over the past five years home prices have escalated dramatically.

Meanwhile, the state of Connecticut mandates a municipal property revaluation every five years. This means your property will be revalued by the town where you live to more accurately reflect the market value of your property. This assessed value, of course, if a key factor in determining your property tax. So, with an increased assessment, there is a likelihood your property taxes will go up.

Another often overlooked consequence of rising property values is the capital gains tax. Simply put, the capital gains tax is a tax on the profit that an investor makes when an investment is sold. For example, if you purchased a home or investment for $100,000 in 2010 and sold it for $200,000 ten years later, you would have a long-term capital gain of $100,000. There are many other factors and calculations, so, for simplification, consider this example. In this case, it is considered a long-term capital gain because the asset was held for more than one year. Long-term capital gains are taxed more favorably than short-term capital gains — gains on assets held less than one year and taxed at your ordinary income tax rate.

You may be thinking, but the government exempts $250,000 for single taxpayers and $500,000 for married taxpayers in capital gains as long as certain conditions are met. The main condition being that you utilized the property as your primary residence for at least two of the past five years. Seems fair, but what happens when you have highly appreciated real estate and you want to give it to your children or other loved ones? If the transaction is not structured properly, your loved ones could be facing a large tax bill.

This is where proper planning can save on capital gains taxes. The IRS allows for what is called a stepped-up basis. Step-up in basis refers to the adjustment in the cost basis of an inherited asset to its fair market value on the date of the decedent's death. For IRS purposes, this simply means the value of the asset is its

value at the time of the owner's passing away. When properly preserved, the step-up in basis can save a substantial amount of money in capital gains taxes.

Some individuals transfer their primary residence to their children prior to death for a variety of reasons. This is where a problem can arise – particularly in the form of the capital gains tax.

If you transfer your home to anyone for less than its fair market value, such as a gift, the person receiving the home or property will take over your tax basis in the property and will lose the step-up in basis that could have been preserved by letting the property pass upon death to the intended transferee. As just noted, when the property is inherited the cost basis passed on is the fair market value of the property at the time of death.

Before transferring real property, particularly property that is highly appreciated in value, it is wise to carefully consider all tax ramifications. Knowing the facts could have a substantial impact on your ultimate decision.

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