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Five things real estate investors should watch for after the November elections

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Regardless of who wins this year's presidential election, it appears that the federal government will be poised to make substantial changes to the 2013 tax rates. Depending on what the government ultimately decides, it could force some real estate investors to cash out investments this year, or, alternatively, encourage investors to immediately avoid paying more taxes by utilizing I.R.C. Section 1031 to make "like-kind" exchanges into new properties. Here are five unsettled tax issues that may persuade real estate investors to make a 1031 exchange in 2013:

Increased Capital Gains Tax Rates: It appears that if the currently discussed deficit reduction plans moves forward after November, the capital gains tax rate will increase by no less than 5% (to 20%). Although, whether the increased rate applies to everyone or only "high income" taxpayers is still undecided. Regardless, the application of the higher rate will likely be based on adjusted gross income, which, unfortunately, will include a large number of real estate investors and small businesses.

Medicare Surtax on Capital Gains: If increased capital gains rates weren't enough, a mostly unnoticed provision of the Patient Protection and Affordable Care Act (aka "Obamacare") calls for a 3.8% Medicare surtax on capital gains for individuals/small businesses with an adjusted gross income over $200,000.00. The surtax is set to go into effect in 2013 and will increase capital gains tax rates by 3.8% regardless of what that rate is set at. Although there is a slim possibility of repeal if the Republicans are successful in November, repeal nevertheless looks unlikely at this point.

Mortgage Interest Deduction: Both Democrats and Republicans have offered plans to rein in tax deductions, and both parties have offered plans that would specifically impact the mortgage interest deduction. While everyone has seemingly backed away from getting rid of the mortgage interest deduction altogether, it is a distinct possibility that the deduction is either capped in 2013, unavailable to "high incomers," or limited to primary residences. This will be a hotly debated topic in the next year, but don't be surprised if it is applied retroactively to 2013.

Installment Sales: Entering into an installment sale is a good way of spreading tax liability over multiple tax years, and with the increase of commercial deals involving seller financing, installment sales have become more prevalent in the last few years. Real estate investors triggering installment sales in 2012 may unintentionally expose themselves to higher tax rates, however. Unless Congress affirmatively weighs in, lower capital gains rates will receive "grandfathered" status for installment sales initiated this year.

Changes to the Estate Tax: Often overlooked by real estate investors is how changes to the estate tax will impact their portfolios. In most instances, heirs may now inherit properties with a "stepped-up basis" that will negate any deferred capital gains tax liability built up during the taxpayer's lifetime. However, so many proposed changes to the current tax have been suggested, that it is difficult to predict what will happen, other than to suggest that the estate tax exception will likely go down and the estate tax rate will likely go up for 2013. Worth noting is that Republicans have suggested doing away with the tax altogether, but this seems very unlikely.

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