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There is a silver lining

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Recent declines in R. E. values coupled with a falling stock market, have many people looking for a silver lining in this economic downturn. Individuals who have invested in R.E. may be accumulating passive losses which they are currently unable to deduct, as well as long term capital loss carry forwards, which have been incurred by disposing under performing stocks. Although these capital losses generate a \$3K per year deduction, it is a minor tax benefit for someone with a large loss carryover. However, it is possible to use both of these carryover losses through one income producing transaction.

Assume that the investor above has \$35K of passive loss carryovers, and \$100K long term capital loss carryover. He also owns a rental property which he can sell for a substantial profit. Given this scenario, the following will result if the rental property produces a \$97K gain on sale.

The rental property capital gain is deemed to be a gain from the disposition of a passive activity, so it frees up the entire \$35K of passive loss which appears as a rental loss on page one of his individual tax return. In addition, the gain flows from Form 4797 to Schedule D where it is absorbed by the \$100K capital loss carryover. In fact, the unused balance of the capital loss carryover (\$3K) also flows to page one of the taxpayer's individual tax return. The end result is the individual has no capital gain, and \$38K of losses which reduce his adjusted gross income. In other words a \$97K capital gain allows recognition of \$135K of loss carryovers.

One caution is that if the capital gain is from a non-passive activity, the passive loss carryover will not be utilized.

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