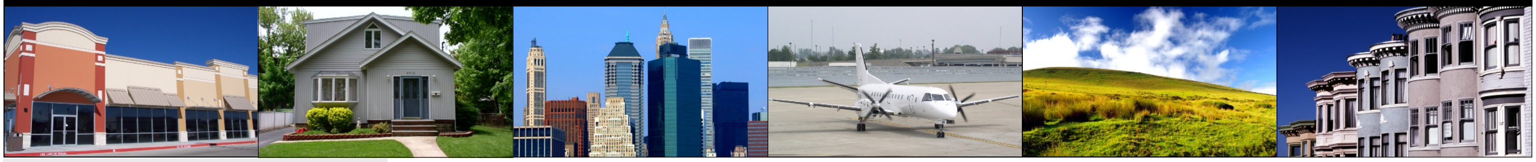
NEW 3.8% MEDICARE TAX

ASSESSING THE IMPACT ON REAL ESTATE INVESTORS



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UNDERSTANDING THE NEW 3.8% TAX OF INVESTMENT INCOME

With potential tax increases looming on the horizon, the value of tax deferral mechanisms, such as Section 1031 exchanges, have never been greater. One example of a potential tax increase which appears likely to take effect is the new Medicare tax, which Congress passed as part of the Health Care and Education Affordability Reconciliation Act of 2010, and was recently upheld by the Supreme Court. The Medicare tax, which goes into effect on January 1, 2013, will impose a 3.8% tax on the net investment income of joint filers with adjusted gross income over $250,000, and single filers with adjusted gross income over $200,000.

The new Medicare tax applies to adjusted gross income (the figure on the bottom of the front page of IRS Form 1040), which includes interest, dividends, capital gains, wages, retirement income and income from partnerships and small businesses. It appears the tax will also apply to dividends, rents, royalties, interest (except municipal bond interest), short and long-term capital gains, the taxable portion of annuity payments, income from the sale of a principal residence above the $250,000/ $500,000 exclusion, gain from the sale of an investment property or a second home, and passive income from real estate and investments in which the taxpayer does not materially participate.

The National Association of Realtors (NAR) has prepared a brochure that contains a summary of the impact of this new Medicare tax on real estate investors and includes examples of several different investor scenarios. Click here to access the NAR Booklet, *The 3.8% Tax: Real Estate Scenarios & Examples*.

OTHER POTENTIAL TAX INCREASES IN 2013

In addition to the new Medicare tax discussed above, the "Bush-era Tax Cuts," which went into effect in 2001, are scheduled to expire at the end of this year. If the Bush-era Tax Cuts are allowed to expire due to inaction by Congress, the Federal capital gain tax rate will increase to 20%, and the highest marginal tax rate for ordinary income will increase from 35% to 39.6%.

THE COMBINED EFFECT OF THE TAX INCREASES ON REAL ESTATE INVESTORS

Future tax rates remain uncertain. But taking into account the imposition of the new 3.8% Medicare tax, and the uncertainty regarding the Bush-era Tax Cuts, on January 1, 2013 taxpayers could face one of three scenarios:

1) If Congress extends the Bush-era Tax Cuts, the top Federal tax rate on long-term capital gains will increase from 15% to 18.8%.

2) If Congress lets the Bush-era Tax Cuts expire, the top Federal tax rate on long-term capital gains will increase from 15% to 23.8%, and the top tax rate on dividends will nearly triple to 43.4%.

3) If Congress extends the Bush-era Tax Cuts, but not for all tax brackets, this will result in a combination of the above two scenarios, and the top Federal tax rate on long-term capital gains will likely rise for higher earners, but not for all tax brackets.

THE TAX CODE TAKETH, THE TAX CODE DEFERRETH-THE INCREASING VALUE OF 1031 EXCHANGES

Despite these potential tax increases, one aspect of the tax code provides real estate investors with a huge tax advantage. A Section 1031 exchange, part of the tax code since 1921, allows real estate property owners holding property for investment purposes to defer taxes that would otherwise be incurred upon the sale of investment property. Savvy investors use 1031 exchanges to redeploy their investment capital into better performing investment properties. An exchange provides a fantastic opportunity for investment property owners to defer capital gain taxes. Call the 1031 exchange experts at Asset Preservation today and visit www.apiexchange.com to learn more about this powerful investment strategy.