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Details Important for Investor to Lock In
Capital Gains On Real Property Prior to Development

Taxpayers holding real estate for investment should be entitled to capital gains on the appreciation in the value of the property during the time it is held prior to development by a related entity. In *Phelan v. IRS* (a 2004 US Tax Court case), a taxpayer sold property to a related entity for development and obtained capital gain treatment on the sale to the related entity. The taxpayer was able to establish that the taxpayer was not holding the property primarily for sale to customers in the ordinary course of business. The Phelan strategy for locking in capital gains is still a valid strategy. However, attention to detail is needed in the event the strategy is subject to an audit.

A recent Tax Court case (*Pool v IRS*; January 2014) illustrates that the Phelan strategy requires attention to detail. In the Pool case, several small factors lead the IRS to conclude that the taxpayer, as the selling entity, was engaged in real estate development as opposed to real estate investment. The Tax Court found that the taxpayer was holding the property primarily for sale to customers before the transfer to a related entity because of several small factors including the following:

- the taxpayer's partnership return listed the partnership's business as "real estate development";
- the taxpayer filed an affidavit with the county identifying itself as the "developer" of a "planned unit development"; and
- the taxpayer constructed infrastructure on the property (water and wastewater facilities) that indicated an intent to develop rather than merely increase the value of the property.

For information on tax planning opportunities for real estate and other business opportunities, please contact Ken Dannenberg (kwdannenberg@martinpringle.com) or Zach Wiggins (zkwiggins@martinpringle.com).