All-cash.—If you pay all cash for the building, you get a depreciation deduction of $5,000 the first year.

> *Using leverage.*—Same facts except that this time, you only put up $25,000 cash and get a $100,000 mortgage at 6%. *Big break:* You still get the full depreciation deduction. That's because your basis for depreciation is the full price of the building—$100,000—despite the fact that you invested only $25,000 cash.

So the $4,000 net rental (remember, $6,000 had to be paid in interest costs) completely escapes tax. And you still have $1,000 in deductions left to offset income from other sources.

The net result is that $5,000 of income escapes taxation. And that's on a cash outlay of only $25,000.

> *Using all-out leverage.*—You own five office buildings. Using the same facts and figures you would have $25,000 of tax-free income on a $125,000 cash investment—and that's hard to top in any league.

HOW TO SUBDIVIDE: SELL AS MANY LOTS AS YOU PLEASE AND STILL COME UP WITH CAPITAL GAIN

As you may already know, the tax law provides a specific statutory path to capital gain—in whole or in part—on sales of subdivided real estate. Why "in whole or in part"? Well (assuming you meet all the other requirements), all of your profit is capital gain until the year you sell your sixth lot. In that year—and later—gain up to 5% of the selling price of all lots sold from the tract is ordinary income; the remainder is capital gain.

"But, you say, ordinary income is exactly what I want to avoid. Is there any way of skirting that 5% deal?"

> *Answer.*—Yes, sell 5 lots in one year, let 5 years pass without selling any more lots from the tract, and then sell 5 more lots. If you follow this path—it will all be capital gain.

"That sounds fine on the surface, but it isn't very practical. After all, who can wait that long to sell real estate? I'd like to unload these lots as quickly as possible. But I'm afraid if I do this the tax law will say I'm a dealer and all my gain will be ordinary income. Isn't there some way out?"

> *Answer.*—Don't sell "the 5% deal" short. It may still be just the thing for you. Chances are that you'll be able to sell as many lots as you want in the first year and still escape being hit with any ordinary income. *Reason:* True, 5% of the selling price will be ordinary income. However, and here is the key, the tax law provides that selling expenses (broker's fees, legal fees, and the like) are first applied against ordinary income; only the excess reduces capital gain. As a result, in many cases, selling expenses will completely offset ordinary income, leaving you with nothing but capital gain to report.

To show you exactly how it might work out, let's take a look at a hypothetical—

Example.—Ten years ago you purchased a 50-acre plot of land in the country for $2,000 as an investment. During the past 10 years, things have changed drastically. Your once-secluded acreage is now surround by housing developments, shopping centers and industry. One thing more has changed—the value of the land. One developer has already offered you $100,000. A local real estate broker, however, had advised you that you could gross at least $150,000 if you subdivide and sell off the lots.

> *Problem.*—What should you do? If you sell to the developer, you'll have a maximum capital-gain tax of $24,500 and a net profit of $73,500. On the other hand, if you subdivide and sell the lots yourself, you may come out even better.

Assume that you subdivide into 100 lots—selling price, $1,500 each. Deducting the cost of the land leaves $148,000—before selling expenses and taxes. Let's say that the selling expenses for each lot total $75. This will bring your profit down by $7,500 (100 lots x $75). Here's how your profit picture will look, even if you sell all of the lots in one year: