

A tax-favored capital gain deal.—Some thirteen years ago, a group headed by Col. Henry Crown bought the building. Financial objective: A top-dollar write-off in the early years, followed by a capital-gain deal when they sold off the property.

How they did it.—When they bought the Empire State Building—they bought only that. The building, that is. The land was owned by the Prudential Life Insurance Co. These investors leased the land from Prudential for a period of 30 years, with options to renew for an additional 60 years. By taking title to the building and leasing the land, in other words, splitting the fee, Crown nailed down its objective.

Here's why.—The building, of course, was depreciable and the Crown group used 150% accelerated depreciation. This provided maximum write-offs in the early years. The land, however, was a different story. It wasn't depreciable. But, by leasing the land instead of buying, these astute investors were able to deduct every cent of the rent.

The trouble with accelerated depreciation is that, after a while, the tax bonanza starts to run out. After 10 years, the depreciation deduction had been drastically reduced. What was worse, it happened at a time when the income from the property was going up. Faced with his situation, the investors were left with one thing to do.

Sell out.—Once the advantage of accelerated depreciation was exhausted, the sale of the building and the lease completed the tax-saving parley. Not only did they get capital gain on the property's increase in value, they also recaptured, at capital-gain rates, all the depreciation that had been deducted against ordinary income in prior years.

What about recapture of depreciation?—True, the 1964 tax law turns some post-63 depreciation back into ordinary income. Despite this, however, you can still reap either all or a substantial part of the benefits we've been talking about.

First of all, there's no recapture at all on buildings held at least 10 years. In our illustration, for example, since the Crown group held the Empire State Building for that period of time, the benefits it reaped wouldn't have been affected in the slightest even if the recapture rules had been in effect.

Suppose you sell the building in less than 10 years? Even here, you can still come out way ahead. *Reason:* As long as you've held the property at least 12 months, recapture of real estate depreciation is limited to the difference between the accelerated depreciation taken and the amount that would've been depreciated by the straight-line method.

Short cut.—To figure out the applicable percentage, simply subtract the number of full months you will have held the property from 120. For example, if you will have held it for 4 years—48 full months—the applicable percentage would be 72% (120 minus 48).

Result: If you hold the property for 7, 8 or 9 years, you'll still convert most of your depreciation into capital gain. Your real estate deal may not be of the skyscraper type—but the tax principles are exactly the same. Your tax adviser is an indispensable man. Consult him first.

HOW TO BYPASS TAX ON CONDEMNED PROPERTY

If your property is condemned and the proceeds exceed your cost basis, you can escape any current tax by making a proper replacement. Actually replacing the old property isn't necessary—rearranging the land you have left can turn the trick. But the use of the proceeds must put you in essentially the same position you were in before.

New case: State condemned part of Plant Owner's land for a superhighway. He had used the grounds as a storage area for his products. Thanks to the forthcoming 6-laner, land costs have skyrocketed, so Owner uses the condemnation proceeds to rearrange the layout of his remaining facilities to build a new storage area there.

Plant owner wins: He doesn't have to pay tax now on his gain. He doesn't have to buy new land; he can spend the proceeds to restore what he has left to its original usefulness.