Brooklyn Real Property, Inc.
BRP Associates, Inc.

When you sell a two-family house, the capital gains are treated differently for the portion you use as your primary residence and the portion you use as a rental property. You may be able to exclude a significant amount of the gain on the residence portion, while the rental portion will likely be fully taxable and subject to depreciation recapture.

1. The Primary Residence Portion

The portion of the property that served as your main home may qualify for the Section 121 capital gains exclusion under federal tax law.

- Exclusion Amount: You can exclude up to $250,000 of the gain if you are a single filer or $500,000 if you are married filing jointly.
- Eligibility Tests: To qualify, you must have owned the home and used it as your main residence for at least two out of the five years leading up to the sale. The two years do not need to be consecutive.
- Prorating: The exclusion is typically prorated based on the percentage of the property used as your principal residence versus the rental unit. For example, if you lived in one unit (50% of the property), only that portion of the gain is eligible for the exclusion.

2. The Rental Portion

The portion of the property that was rented out is considered an investment property and the gain from its sale is generally subject to capital gains tax.

- Capital Gains Tax Rates: The profit (gain) from this portion will be subject to federal long-term capital gains tax rates (0%, 15%, or 20%, depending on your total income) if you owned the property for more than a year.
- Depreciation Recapture: A key factor for rental property is depreciation recapture. Any depreciation you claimed as a tax deduction while renting out the unit must be "recaptured" and is typically taxed at a flat federal rate of 25% when you sell the property.
- State and Local Taxes: In New York, capital gains are taxed at ordinary state income tax rates, which can be up to 10.9%. New York City residents may also be subject to local city income tax.

3. Reporting and Strategies

- Calculating the Gain: Your capital gain is generally the selling price minus your adjusted basis (original cost plus cost of capital improvements, minus depreciation claimed).
- Form 1099-S: You will likely receive a Form 1099-S, Proceeds From Real Estate Transactions, which requires you to report the sale on your federal tax return. You will use Form 8949 and Schedule D (Form 1040) to report the gain.
- 1031 Exchange: For the rental portion of the property, you may be able to defer capital gains tax through a Section 1031 exchange, which allows you to reinvest the proceeds into a "like-kind" investment property.

It is highly recommended to consult with a qualified tax advisor or real estate attorney to understand your specific tax liability and explore potential strategies to minimize your tax burden. You can find more information in IRS Publication 523, Selling Your Home.