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Dealer Or Investor?

Often clients ask about the tax consequences of a particular real estate transaction they are planning, and the answer is an ambiguous "It depends." The reason for this is the difference in the way the IRS treats investors as compared to dealers, and the criteria by which the IRS determines the taxpayer's status. Typically, a seller of real estate who has gain in the property being sold wants to be classified as an investor (taxed at a 20% capital gain rate) rather than as a dealer (taxed at a 39.1% ordinary income rate). Section 1221 defines a capital asset as "…property held by the taxpayer primarily for sale to customers in the ordinary course of … trade or business." However, the Code does not specify exactly by which characteristics a property falls into this category. Therefore, the courts have defined a test with seven factors that has been used to determine on a case by case basis whether the taxpayer is a dealer or an investor. It is important to remember that none of these seven factors is decisive on its own, and some may carry more weight in the determination than others.

Classification Factors	*Dealer*	*Investor*
Acquired and held property for sale to customers	Yes	No
Made substantial effort to sell property	Yes	No
Large number, extent, continuous, and substantial sales	Yes	No
Subdivided, developed, advertised to increase sales	Yes	No
Used business office for sale of property	Yes	No
Supervised or controlled selling representative	Yes	No
Habitually devoted extensive time and effort to sales	Yes	No

Conclusion: A taxpayer must consider all the facts and circumstances of his particular situation to determine whether he will be classified as a dealer or an investor when selling real estate.

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