Once a building sale closes, the federal government taxes the long-term gain. Don't forget the new Affordable Care Act tax for any asset sold for more than $250,000. Next comes the Golden State for its share.

Selling commercial property to pay for a child's college tab?

Last week, our team was contacted by an owner who wanted to sell his building and redeploy the equity into a college education for his children. It's a noble cause, to be sure, but one with some considerations.

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Contributing Columnist

Are you taxed? Yes! You see, once the sale closes, the federal government will tax the long-term gain — appreciation of more than a year. Taxed at a higher level will be the depreciation recapture. Don't forget the new Affordable Care Act tax for any asset sold for more than $250,000. Oh, yeah — then our Golden State will want a taste as well. For those keeping score, all of the taxes can amount to almost half your gain. Ouch!

Outlined above is the first thing that occurs once your building sells: You're taxed out the wazoo — unless of course, you employ some tax deferral strategy, which defeats the use of the equity for a college education.

What happens to your tenants? In our example, the real estate is occupied by three businesses, two of which have leases and one that doesn't.

The easy answer is: As long as the tenants with leases continue to pay their rent and abide by the terms of their contract, no interruption in their occupancy should occur. We're assuming the new owner and landlord would adhere to the terms and conditions of the lease agreement(s) in place: the rent, term, increases, extension rights, etc.

A much different story unfolds for the poor dude without a lease, however. You see, he is vulnerable. His rent can be jacked up or he can be asked to vacate. Best case: The new owner allows him to stay and offers a new lease with the same rent he enjoys — highly unlikely in today's supercharged market.

Gotchas? Sure. Again, the tax man. Upon sale, the real estate is reassessed for property taxes. Generally, property taxes are rebooted to the selling price. So who pays the increased amount? Yep. Generally, the tenants — assuming of course the leases allow for this "pass-through" — which most commercial leases accommodate. Who cares? Well, you should! You're strapping your loyal occupants with an increase in their monthly outflow. Or, short of the "pass-through" provision — the buyer pays you less because he must swallow the new property tax.

Special circumstances? Certainly. Before racing out to the market with that sale package, carefully consider your tenant(s) extension rights — options to renew lease(s), the ability to take over additional space or ways to cancel. ALL of those circumstances can affect the value of your building. Did you agree to allow your occupant to buy the building through an option to purchase, a right of first refusal or a right of first offer? If so, you must follow a protocol tantamount to a NASA launch sequence before openly marketing your holding.

Is your tenant the BEST buyer? Quite possibly. Short of any "rights to buy" you may have granted, the company that pays you rent each month could surprise you and offer you the most. After all, it "lives" there and has for some time. In many cases, your tenant knows the building better than you do. Faced with a move vs. converting a lease to ownership — buying can make sense.

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