Capital Idea

Changes in the Law Greatly Benefit Those Selling Their Homes

By HYMAN G. DARLING, Esq.

Your home is likely your greatest investment, and fortunately, the IRS provides significant tax benefits upon the sale of it, which have evolved to more greatly benefit you. Many people remember the old rule that one had to be at least 55 years old in order to take advantage of the benefits. That rule is now history, and age is irrelevant with respect to exempting tax on capital gains upon the sale of a home.

Similarly, it is no longer required that you have to spend as much money on a replacement home, or even buy a new home, to exclude the tax on the gain.

The updated federal tax law (and also the law in most states) provides that, if you have lived in a house construed to be your personal residence for a period of two years out of the last five years, upon the sale of the property, if you are single, you exclude the gain on the first $250,000, and if married, on the gain on $500,000.

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It is important to note that the amount that is excluded is the gain, which is the amount above your basis. The basis of the property, in most cases, is the purchase price plus improvements (not repairs) on the property. Therefore, it is very important to maintain accurate records to establish an accurate basis of the property. If there is a gain of greater than the amounts listed, then capital gains will be assessed upon the sale of the property. If that is the case, you should contact your accountant to be sure that the basis is calculated correctly, and if necessary, estimated taxes should be paid to both the Internal Revenue Service and state so that you will not incur any penalties for underpayment of taxes.

This advantage of excluding the gain so long as the property was owned and used as a personal residence for two years is a significant departure from prior rules. In this situation, you may sell your house every two years without having to reinvest any amount in a new residence.

In fact, there are some people who make a living buying and selling properties. By living in the property for two years as their personal residence, they basically exclude all the gain. However, since they are not paying taxes, and since the gain is exempt, if this is their only job, their own personal Social Security contributions are nil, and therefore, upon retirement, they will not receive any significant Social Security benefit. Nevertheless, such people earn a living on capital gains without taxation.

There are also rules for someone who has to be institutionalized in an assisted-living facility or nursing home. Such individuals do not have to sell their house within two years of moving out of it. In these situations, the homeowners have an extended period of time to sell the house without paying tax.

Another consideration when selling property relates to people who are going to be married or getting divorced. Since the exemption on the gain is available only every two years, it is important that, if you are getting married and you and your future spouse each own a home, you understand that it may be desirable to sell your property before marriage, and thus exclude gain on both properties before marriage. If this was not attended to properly, then you may opt to file your tax return as married filing separately to take advantage of the exclusion, although your other income may be taxed at a higher rate, since you are not filing a joint return.

If you own a multi-family home, you have probably depreciated a portion of your property over the years, thus taking the benefit of paying less in income tax and utilizing the depreciation as an expense. However, the portion of the property that was not depreciated is still subject to the exclusion for capital gains so long as that portion of the property was utilized as your personal residence. In addition, the land portion of both the purchase price and sale price would not be depreciated, and therefore, it is important to not lose the benefit of the exclusion on the gain on the land portion of your rental property.

When selling your home, your attorney will present you with a form to complete relative to taxing gains on the sale. If the sale price is less than the exemption amount (not the sale price), and if the appropriate

exclusion exemptions apply, then you will not receive a 1099 form, because the sale itself is an exempt transaction. However, if the property is being sold as a non-exempt sale — for example, it was not your personal residence, or the property is being sold by an estate, or part of the property was depreciated — then you will receive a form 1099, which needs to be reported on your income-tax return for the year of the sale. If not, you will receive a notice from the IRS.

In some cases, the IRS computer matching system will trigger a letter to you if the sale price is not properly reported, and in some cases, the IRS has even assessed a tax on the entire amount of the sale if the 1099 amount does not match the amount reported on the income-tax return for the sale.

The IRS has a relatively straightforward publication, number 523, that should be referred to as a guide in determining the gain or loss for properly reporting the sale of a personal residence, but as always, there is no substitute for getting good advice from your accountant prior to, and certainly after, the sale. ❖

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