

Understanding the home sales rules

For many of us, the equity that we have built up in our homes represents a comfortable nest egg for the future. At retirement many people sell the family residence and move to smaller, less expensive home. The freed-up money, thereafter invested, may be a valuable source of retirement income or allow for a substantial down payment on a second home.

Help from Uncle Sam

The gain from the sale of your home is, potentially, subject to the capital gains tax. But a generous *exclusion* from that tax is available—\$500,000 for married couples (\$250,000 for singles). And this tax break is generous not only in amount: There is no age requirement imposed for taking advantage of the exclusion, and in the right conditions, there is the opportunity to use the exclusion once every two years.

The two major conditions? The home for which you use your exclusion must be your “principal residence,” and you must have owned and occupied this principal residence for at least two of the previous five years before the sale.

Questions answered

The Internal Revenue Service has provided answers to some of the more common questions about how the exclusion works. Here are a few of the key points from the IRS regulations:

1. *The principal residence definition.* Although the amount of time that you spend in your home is a good indicator of whether it is your personal residence, it is not the sole consideration. Other factors can include such items as: your place of employment; where your family lives; addresses on correspondence and tax returns; where you maintain your banking relationships. Where you vote, the address on your driver’s license and the property on which you claim a property tax exemption also might help resolve the personal residence question. In sum, “facts and circumstances” will be the test applied.

2. *Fulfilling ownership and use requirements.* Two years of ownership and occupation is defined as 24 full months, or 730 days, but need not be concurrent, says the IRS. Short absences such as summer vacations still will be counted as periods of use, but longer breaks, such as a one-year sabbatical, will not.

3. *Marital status.* When taxpayers are not married and jointly own a principal residence, as long as all rules are met, each of them is entitled to a \$250,000 exclusion.

4. *Vacant land.* The home sale exclusion may include gain from the sale of vacant land that has been used as part of a principal residence, as long as the land sale occurs within two years before or after the sale of the residence.

The partial gain rules

What if you don't satisfy the two-year rule? All is not lost. The IRS allows you a partial exclusion for a change in employment, for health reasons or in "unforeseen circumstances." The new guidance offers clearer definitions of these exceptions.

Employment change. The change may be yours, your spouse's or a person whose principal place of abode is in your home. The new workplace must be at least 50 miles farther from the old home than the old workplace was from that home.

Health. The primary reason for the sale must be related to a disease, illness or injury. A physician's recommendation of a change in residence for health reasons will satisfy this requirement. Sales relating to the necessity to care for a close relative who is sick may fall within this exception.

Unforeseen circumstances. The IRS has defined this term to include death; divorce or legal separation; becoming eligible for unemployment compensation; a change in employment that leaves you unable to pay the mortgage or reasonable basic living expenses; multiple births resulting from the same pregnancy; damage to the residence resulting from a natural or man-made disaster, or an act of war or terrorism; and condemnation, seizure or other involuntary conversion of the property. Any of the first five items listed above must involve the taxpayer or his or her spouse, co-owner or member of the taxpayer's household in order to qualify as "unforeseen circumstances." The IRS has the discretion, too, to determine additional situations that will meet the definition.

Retroactivity. The IRS guidance specifically states that these new rules may be applied retroactively to principal residences that were sold in the past.

If you are selling your home and want to take advantage of the home-sale tax exclusion, we recommend that you consult your tax advisor well in advance of the sale in order to avoid any unpleasant surprises or complications.

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