

100308 Changes in How House Sales are Taxed By Gary Case

For a number of years, many people have benefited from favorable tax treatment of gains realized from the sale of a primary residence. That could be changing for some who have made a business of “flipping” properties to take advantage of that favorable tax treatment.

Part of the housing-stimulus packaged signed into law could reduce—though not eliminate—the appeal of a tax-saving strategy used by those who own more than one house. The new law will affect some people planning to sell their primary residence, claim the full home-sale exclusion to pay little or no capital gains taxes—then move to another house they’ve owned for some time, convert it into their primary residence, and sell once again and pay little or no capital gains tax.

Most homeowners can sell their primary residence and exclude as much as \$250,000 (single taxpayer) to \$500,000 (joint filers). To qualify for the full exclusion, owners typically must have owned the home and used it as their primary residence for at least two of the past five years prior to the sale.

Under the new law, which takes effect next year, many owners might not be eligible to claim the full exclusion on a house they convert to a primary residence. The new law disallows gain from the sale of a home allocated to periods of “non-qualified use.” That typically refers to any period when the property isn’t used as a principal residence.

Here’s an example: A married couple buys a home on January 1, 2009 for \$200,000. They plan to hold it as an investment. On Jan 1, 2012—three years later—they begin using it as their primary residence. They live there two years and sell it on January 1, 2014 for \$500,000, for a profit of \$300,000. Under the old law, they would have been able to exclude the entire \$300,000 gain. But under the new law, they could exclude only two-fifths of the gain, or \$120,000, since the other three-fifths would be attributable to the three years the home wasn’t their principal residence.

There are exceptions to the new rules, but relying solely on common sense when purchasing a second home could be costly. Prior to purchasing a second house, consider consulting a professional conversant in real estate taxation. More information on the new law can be found at www.jct.gov, the Web site of Congress’s Joint Committee on Taxation.

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