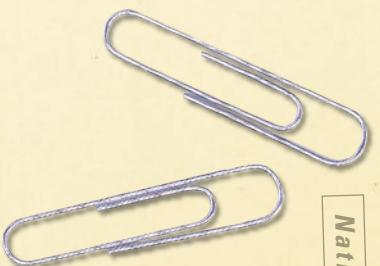


Sale of a Personal Residence

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Sale of a Personal Residence

The Taxpayers Relief Act of 1997 drastically changed the rules for reporting gain on the sale of a personal residence. The law now provides for a universal exclusion of \$250,000 for a single person and \$500,000 for a married couple for gain realized on sales of personal residences on or after May 7, 1997. The new rules have generally made recordkeeping less onerous for taxpayers and they allow most homeowners to pay no income tax on these sales. An obvious advantage of not being required to pay tax on the sale allows taxpayers to make decisions based on their needs and wants rather than on the tax consequences. This is especially beneficial to taxpayers who relocate from an area of high home values to an area of more moderate values.

WHAT ARE THE REQUIREMENTS TO BE ELIGIBLE FOR THE EXCLUSION?

- The home must be the principal residence of the taxpayer. It must have been owned and used as the principal residence for 2 or more years during the 5-year period ending on the date of the sale.
- The exclusion is available regardless of age and will be available for more than one principal residence as long as the taxpayer does not use it more than once every 2 years.
- For married taxpayers, the \$500,000 exclusion is available if either spouse meets the ownership test and both spouses meet the use test. In addition, neither spouse can have used the exclusion in the past 2 years.

WHAT HAPPENS IF I NEED TO MOVE BEFORE THE 2-YEAR PERIOD IS UP?

Taxpayers may be eligible for a partial exclusion if they fail to meet the ownership and use requirements due to:

- A change in place of employment;
- Health; or
- Unforeseen circumstance. Possible unforeseen circumstances could be death of a spouse, divorce, or some other major problem.

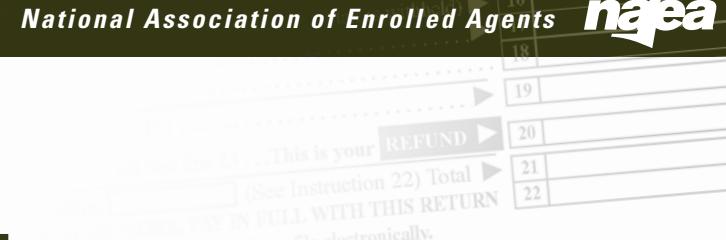
There was concern over how the exclusion would be calculated. In 1998, Congress offered clarification on how a partial exclusion would be calculated. The taxpayer can use a pro-rata of the \$250,000/\$500,000 exclusion rather than the pro-rata of the gain. For example, if the taxpayer was forced to sell after one year due to health problems, the taxpayer would be entitled to an exclusion of 50% of the full amount. This is much more favorable than an exclusion of 50% of the gain.

WHAT IF I RENT MY HOME FOR A PERIOD OF TIME PRIOR TO THE SALE?

Renting a home will not disqualify a taxpayer from using the exclusion. As long as the 2-year ownership and use tests are met, the home will retain its personal residence character. Be aware that any depreciation claimed on the rental use of the house after May 6, 1997 must be recaptured and is subject to ordinary income tax.

WHAT HAPPENS IF I HAVE A TWO-FAMILY HOUSE AND I SELL?

If the entire property is not used as a principal residence then the sale will be considered as two sales. The first sale will be the personal residence portion and will be eligible for the exclusion. The second sale will be the business use portion and will not be eligible for the exclusion.



The gain on this "second" sale will be taxable. The same type of calculation will be applicable for taxpayers who have an office in the home in the year of sale. The personal residence portion qualifies for the exclusion but the "business" portion (i.e., the home office) will not and tax will be due on the gain.

WHAT IF I SELL MY VACATION HOME?

Only personal residences qualify for the exclusion. However, it is possible to sell a principal residence, claim the exclusion on that sale and move into the vacation home thus making it your new principal residence. After 2 years, this home could in turn be sold and a new exclusion would be applicable on this sale.

WHAT HAPPENS IF I SELL MY HOME AT A LOSS?

A loss on the sale of a personal residence is not deductible on a tax return.

WHAT HAPPENS IF AN ELDERLY TAXPAYER MUST RESIDE IN A NURSING HOME?

There is special relief for taxpayers who become physically or mentally unable to care for themselves and who reside in a licensed care facility. The time spent in the nursing home is considered time spent in the principal residence for purposes of the 2-out-of-5-year residence rule. This applies as long as the taxpayer used the residence as a principal residence for at least one year during the 5-year period prior to the sale.