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You May Be Able to Exclude All or Part of Any Gain from Selling Your Home

A number of seniors decide to sell their home so they can cash in on the equity to help improve their quality of life in retirement. The question is, how big a bite will taxes take out of the proceeds?

As in all things tax-related, the answer depends on your exact situation. Here's the general rule: if you have a gain from the sale (exchange) of your main home, you may be able to exclude all or part of the gain from income. To be eligible for this exclusion, you must have owned your home and used it as your primary residence for at least two years out of the last five years prior to its sale or exchange. The required two years of ownership and use during the five-year period ending on the date of sale do not have to be continuous. You can meet the ownership and the use tests during different two year periods (www.irs.gov/taxtopics/tc701.html).

How does this translate into reality? This means that vacation homes don't normally qualify. And, if you have already excluded gains from the sale of another home within the most recent two-year period, you probably will have to report and pay taxes on the gain from your current home. Note that you have to meet **both** the ownership and the use tests to exclude any gain from the sale of your home.

Okay, you qualify. Now, how much of the gain can you exclude? If you are single, you can exclude up to \$250,000 of gain. If you are married (filing jointly), and at least one of you meets the ownership test, and both of you meet the use test, you can exclude up to \$500,000 of gain. If you did not meet the ownership and use tests, but you are selling your home because of a change in place of employment, your health, or certain unforeseen circumstances, you may qualify for a reduced exclusion.

Remember, potentially taxable gains are determined using your basis in the home as the starting point. Essentially, this includes the purchase price plus the cost of any improvements you

made. If you have lived in the home for many years and made a number of improvements, you might not have as much taxable gain as you think.

One final point (this is the part where we issue a disclaimer): any time you are dealing with the IRS, getting qualified tax advice is a very good idea. With most situations, this one included, there are little bits and pieces that can affect your particular circumstance. Since taxes on \$250,000 or \$500,000 could be substantial, it would be wise to consult an expert.

For more information:

- www.bankrate.com/brm/news/real-estate/20041018a1.asp. Bankrate, Inc. continually surveys approximately 4,800 financial institutions in all 50 states to provide objective and unbiased rates to consumers. The flagship web site, Bankrate.com, provides free rate information to consumers on more than 300 financial products.
- www.kiplinger.com/personalfinance/features/archives/2005/01/taxguide2.html. This article by *Kiplinger* covers the nuts and bolts related to the sale of a home.
- www.smartmoney.com/taxmatters/index.cfm?story=20030108. This article by Smartmoney.com covers a number of home sale scenarios. The site also offers a free evaluation copy of its companion magazine *Smart Money* (subscription).

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