

TAX RULES THAT APPLY TO SELLING YOUR HOME

Last year, six million Americans sold homes. Some of these sellers sold homes in which they rented out rooms or used a portion for business purposes. Still others were in the military, changed jobs, or experienced an unforeseen event – such as the birth of twins. According to the federal tax code, each one of these situations can impact a home-seller's taxes.

Figuring Gain or Loss

Regardless of your individual circumstances, you will need to determine if you have a gain or loss on the sale of your property. Figuring out gain or loss involves some calculations. First, you must determine the amount realized on the sale. Commissions, brokerage fees, any points paid to help the buyer get the loan, and other selling expenses are subtracted from the gross selling price. Thus, the gross selling price less expenses equals the amount realized on the sale.

Next, you must determine your basis in the property. Basis is the foundation for figuring a gain or loss. Generally, your basis is the cost of your home. Any major changes you have made to the property increase the basis. For example, if you replaced your roof at a cost of \$2,500, the adjusted basis of your house increases by \$2,500. Basis also includes closing costs and settlement fees you paid when you purchased the home.

Subtracting the adjusted basis from the amount realized through the sale tells you whether your sale produced a gain or a loss.

Sometimes It's Nice to Be Excluded

Fortunately, if a homeowner realizes a gain, most can exclude up to \$250,000 of that profit (\$500,000 for a joint return) from taxable income. All that is required is that the seller owned and lived in the house for two years during the five-year period ending on the date of the sale. This is known as the "ownership and use test." The two years do not have to be continuous. And even the two-year rule has some exceptions, discussed

below. Also, a member of the armed services may have the five-year period suspended if he or she is on official, qualified, extended duty.

If you do not meet the ownership and use tests, you may still get a partial exclusion, provided you had to sell the home because of a change in place of employment, or health issues, or because of circumstances you could not have anticipated when you bought the home, such as, yes, the birth of twins.

NOTE: You cannot sell two homes in a two-year period and exclude the gain on both. Also, unfortunately, if you sell your home at a loss, the loss is not deductible.

Business or Rental Use of Your Home

If you've used part of your home for business or rental purposes, you still may be able to exclude most of your gain, provided you meet the ownership and use tests.

As long as the business or rental area of your home was in the *same* building or structure as your living area, you may exclude gain up to the \$250,000 (\$500,000) limit except for depreciation allowed or allowable. The depreciation taken as a deduction on your return is taxed at a maximum 25 percent capital gain rate.

Example: Dan sold his main home in 2003 at a \$50,000 gain after living there ten years. However, he used one room of his home for business in 2002 and claimed a \$1,000 depreciation deduction. He can exclude \$49,000 of his gain but will be taxed on that \$1,000 at 25 percent.

Different rules apply if you sold rental property that was in a separate structure from your main home — for example, a duplex.

For taxpayers who sell their homes, the deal's not really done until you figure out your gain and whether or not it is taxable. IRS publication 523 (available at www.irs.gov) provides detailed instruction on how to figure your gain and other useful information about selling your home.