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## EXCLUSION OF GAIN FROM SALE OF HOME

By Victor Sy, CPA, MBA

Internal Revenue Code Section 121 allows you to exclude gain from the sale of your home. Tax savings can be substantial. **Let's review 10 rules and tips:**

1. You can **exclude gain of \$250,000** (\$500,000 if you are married filing a joint return).
2. You can avail of this exclusion once **every two years**.
3. Only a **principal** residence is eligible. Second homes and vacation homes are not.
4. To be eligible for the bigger **\$500,000 exclusion** for joint filers,
  - A. At least one spouse must pass the ownership test, and
  - B. Both spouses must pass the use test.
5. You must have **owned** the property for at least two of the five-year period ending on the date of sale and must have **used** the property as a principal residence for at least two of the same five-years.
6. If you can't meet these tests, don't give up. Work out a reduced exclusion.
7. The **reduced exclusion** is available only if any of the following are true:
  - A. Change of job location,
  - B. Health considerations,
  - C. Unforeseen circumstances (includes foreclosure or voluntary conveyance).
8. If you use **two homes**, the property that you use majority of the time will be considered your principal home. There are relevant factors to determine which one is your principal residence, including:
  - A. Your place of employment and principal place of abode of family members,
  - B. Address on your income tax, driver's license, DMV auto registration,
  - C. Mailing address for bills and correspondence,
  - D. Location of banks, church, and recreational clubs.
9. A home that was used as a **rental or home office** does not disqualify you from the exclusion, as long as you meet the two basic tests for ownership and use. The IRS issued a liberal final regulation that does not require recapture of depreciation before May 6, 1997 if both are contained in the same dwelling. This safe harbor does not apply to home office in a separate dwelling **or depreciation** after May 5, 1997.
10. Be careful when having your residence deeded to a **living trust**. Upon death, if the A/B trust splits into a revocable trust (Survivor's Trust A) and an irrevocable trust (Bypass Trust A), there could be tax consequences. If the residence is assigned to the **irrevocable trust, the exclusion is lost**. That may not be a problem initially because of stepped-up basis, but if the value continues to appreciate (and it will), the resulting gain on the death of the surviving spouse will be taxable. In other words, discuss with your estate planner the wisdom of assigning the principal residence to Trust A for the surviving spouse.

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**TIP 1:** If you sell a jointly owned home which is the principal residence of two (or more) single owners, each owner may exclude \$250,000.

**TIP 2:** Always report the sale of your home in Schedule D, even if under the gain exclusion limits of \$250,000/\$500,000. This reduces your audit profile. You will not pay any capital gains tax anyway.

Recent Law Helps Homeowners Facing Debt Discharge Income From Foreclosures & Repossessions:

The Mortgage Relief Act created a new exception for certain discharges of home mortgage debts that occur from January 2007 through December 31, 2009 (extended through 12/31/11). The new exception only applies to a debt that's used to acquire, construct, or improve a principal residence. It helps if you borrowed too much to acquire, build, or improve a principal residence. It does not apply to vacation home mortgages, a taxpayer in bankruptcy, and any factor not directly related to a decline in the value of a residence or taxpayer's financial condition.

The new law also helps **widows and widowers** get the bigger \$500,000 (instead of \$250,000) exclusion.

**Mortgage Insurance premiums** for qualified mortgage on your qualified residence are treated as qualified residence interest paid or accrued 1/1/07 through 12/31/10.