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Sale of Personal Residence

What we are trying to do here is to give you an outline of the tax effects of selling a residence. The main issue is: the potential capital gains you will realize, and how much tax you may owe.

When selling your primary residence, a portion of the gain realized on the sale(or perhaps all the gain) may be excluded from federal tax, if you meet certain current year 2000 IRS qualifying tests.

This exemption of gain works as follows:

1) The house sold must be your primary, qualifying residence for at least two years out of a five year period to get the full benefit.

2) The amount of gain that can be excluded from tax is up to $250,000 for a single filer, and up to $500,000 for joint filers.

3) This exclusion may be used once every two years. In effect, if you sell one house and use the exclusion, you can buy another residence and start all over again. This means you could conceivably buy and sell residences perpetually and avoid all the capital gains taxes.

How is the gain that is eligible for this exclusion calculated? Basically, it is the residence sale price, less qualified closing costs (like real estate commissions, legal fees, etc.), less the original cost of the residence and all improvements put into it. This gives you the net gain which is then compared to the $250,000 (or $500,000) exclusion amount. If the calculated gain is less than the IRS allowance, there is no tax to pay. If the gain is more, you pay tax on the differential amount.

Note the two major differences between this new law (under code section 312) and the old laws (under code sections 121 & 1034). First, you no longer have to replace a residence with another. There is no "buying up" option. Second, there is no provision for any "once in a lifetime exclusion of gain" based on any age qualifications. Rather, you are eligible for the $250,000/$500,000 exclusion on each qualifying residence you sell - as many times as it occurs in your lifetime.

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