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Review of the current tax rules – selling your home

The Taxpayer Relief Act of 1997 amended Federal Tax Code Section 121 for sales of a principal residence occurring after May 6, 1997, and also repealed the former regimen relating to such sales. Under the new Section 121, a homeowner can generally exclude from gross income up to \$250,000 (\$500,000 for married couples filing jointly) of gain realized on the sale of his or her principal residence. The homeowner must have owned and used the property as a principal residence for at least two of the five years immediately preceding the date of the sale, and the exclusion can be used once every two years. A principal residence can include a home, a house trailer, or even stock held in a cooperative housing corporation. Note, however, that the IRS contends that the exclusion is not available for any portion of the residence used for business purposes during the two-year use period.

The two-year ownership and use requirement is satisfied by establishing ownership and use for twenty-four months or for 730 days. Occupancy of the residence during that time is required, but temporary absences—such as seasonal vacations—may be disregarded and therefore not reduce the period of time of occupancy. With respect to ownership, generally the taxpayer must own the property directly, and not through an entity such as a family limited partnership.

As stated, the amount of gain that can be excluded from gross income is \$250,000. That amount is increased to \$500,000 for married taxpayers filing jointly, if: (i) either spouse satisfies the ownership requirement; (ii) both spouses satisfy the use requirement; and (iii) neither is ineligible because of a prior exclusion within the two year period prior to the date of the current sale. If the married couple does not meet all three of these requirements, they may still exclude the aggregate sum of each spouse's maximum exclusion as determined on a separate basis, as a reduced exclusion is available for homeowners that do not satisfy either the ownership and use requirements or the once-every-two-years rule. This reduced exclusion applies if the sale is necessitated by a change in employment, health, or other unforeseen circumstances.

If the home is transferred to a spouse/former spouse pursuant to a divorce decree, the period of time that the transferring spouse has owned the property carries over to the receiving spouse, although the receiving spouse generally must still individually satisfy the two-year use test to qualify for the entire exclusion. Furthermore, if a taxpayer's spouse is not living on the date of sale of a home and that taxpayer has not remarried at the time of sale, then the period of time that the deceased spouse owned the property and the period of use by the deceased spouse of the home as a principal residence will both carryover to the surviving spouse. Note, however, that the full \$500,000 exclusion is only available when the sale occurs within two years after the deceased spouse's death.

Finally, no information is required to be filed with the IRS if all gain from the sale of a principal residence is excluded by Federal Tax Code Section 121. Additionally, a closing agent is not required to file anything if a seller is able to provide written assurances that the gain is entirely excluded. If not all gain is excluded, the recognized gain is reported on Schedule D of the taxpayer's return. Regardless, under any circumstances, other taxes may apply to the sale, chief among which is the Pennsylvania Realty Transfer Tax.