

Understanding Capital Gains in Real Estate

Capital Gains - Profit made from buying real estate and reselling it at a higher price.

When you sell a stock, you owe taxes on your gain, which is the difference between what you paid for the stock and what you sold it for. The same is true with selling a home (or a second home), but there are some special considerations. What you paid for the home includes not only the original price, but also the cost of many improvements, *so hold onto your receipts!*

How to calculate gain - the basics

In real estate, capital gains are based not on what you paid for the home, but on its adjusted cost basis.

1. Take the purchase price of the home: This is what the home sold for, not the amount of money you actually contributed at closing.
2. To the purchase price, add the following things which also cost you:
 - Cost of the purchase - include transfer fees, attorney fees, inspections, but not points you paid on your mortgage.
 - Cost of sale - including inspections, attorney's fee, real estate commission, and money you spent to fix up your home just prior to sale.
 - Cost of improvements - including room additions, deck, etc.
3. The total you get from above is the "adjusted cost basis" of your home.
4. Subtract this adjusted cost basis from the amount you sell your home for. <--- **This is your capital gain**

Special real estate exemption for capital gains

Since 1997, up to \$250,000 in capital gains (\$500,000 on a joint return in most cases) on the sale of a home is exempt from taxation if you meet the following criteria:

- Owned the home for at least 2 years and
- Lived in the home as your main home for at least 2 of the past 5 years.

*Also note that as of 2003, you may also qualify for this exemption if you meet what the IRS calls "unforeseen circumstances" such as job loss, divorce, or family medical emergency.

Which receipts to keep?

The partial list is below from IRS Publication 523

- ◊ Additions to your home, including: Deck, Porch and Patio
- ◊ Heating and Air Conditioning: Duct work, Central Humidifier
- ◊ Lawn and Grounds: Landscaping, Fence, Sprinkler System, Swimming Pool
- ◊ Plumbing: Water Heater, Filtration System
- ◊ Interior Improvements: Kitchen Modernization, Flooring, Wall-to-Wall Carpeting
- ◊ Miscellaneous: Satellite Dish, Security System, New Roof

FOR FURTHER INFORMATION

Tax Topic 409 - Capital Gains and Losses

www.irs.gov/taxtopics/tc409.html

Tax Topic 701 - Sale of Your Home

www.irs.gov/taxtopics/tc701.html

IRS Publication 523 - Selling Your Home

www.irs.gov/pub/irs-pdf/p523/pdf

Tax Facts About Capital Gains and Losses

www.irs.gov/newsroom/article/0..id=106799.00.html

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