



New Bill Impacts Capital Gains Exclusion

The Housing and Economic Recovery Act of 2008 passed into law with a lot of positives for the American people.

But the new housing law isn't *all* good news for Americans. Buried deep on page 690 of the 694-page law, for example, is an important change to the Capital Gains Exclusion rule that could cost home sellers across the country a pretty penny.

Under the former Capital Gains Exclusion rule, home sellers could claim \$250,000 of home sale profits tax-free (\$500,000 if filing jointly) provided they physically lived in the home for 2 of the previous 5 years. The new rules are targeted at the savvy investors who were buying a property, living in it for two years, then moving on to the next property and keeping the old one as a rental.

Under the *new* Capital Gains Exclusion rule, however, this sort of tax-minimizing behavior is rendered impractical. The new Capital Gains Exclusion formula is not an all-or-nothing proposition. Instead, it's a ratio.

The new formula for Capital Gains Exclusion accounts for a home's actual qualified use as a primary residence:

Capital Gains Exclusion	=	Profit from the sale of the home	*	$\frac{\text{Number of days the home was "primary"}}{\text{Number of days the home was owned}}$
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Source: US Government

Nonqualified Use Includes: Any period during which the property is not used as the principal residence of the taxpayer or the taxpayer's spouse or former spouse."

Nonqualified Use Does Not Include: Any period (not to exceed an aggregate period of 10 years) during which the taxpayer or the taxpayer's spouse is serving on qualified official extended duty.

Nonqualified Use Does Not Include: Any other period of temporary absence due to change of employment, health conditions, or such other unforeseen circumstances as may be specified by the Secretary.

In other words, if a home seller occupied a property as a primary residence in 2 of the last 5 years, under the new system, he would be entitled to 40% of his capital gains tax-free versus 100 percent of those gains *before* the new housing law passed.

EXAMPLE OF BEFORE VS. AFTER

Say you bought a home for \$200,000 5 years ago. You moved out of it three years ago so you could buy your new home. You're now selling the home you bought 5 years ago for \$225,000. Your profit is \$25,000.

Before:

You have no capital gains tax liability on this profit. It didn't matter if you moved away from that property after two years and turned it into an investment property.

After:

Since you lived in the home 40% of the time, you'll be responsible for capital gains on \$15,000 of that profit.

The effective date for the new Capital Gains Exclusion rules is January 1, 2009 so homeowners selling in 2008 are exempt. This should lead to flurry of housing activity prior to the New Year because home sellers will want to capture as much of their real estate gains as possible tax-free.

To read the actual legislation go to: http://www.house.gov/apps/list/press/financialsvcs_dem/hr3221_bill_text.pdf



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