Capital Gains Taxes

by Ilyce_Glink

Q: My wife and I purchased our new home in December, 2004. The builder financed 100 percent of the purchase price of $146,500 at 5 percent, which was great. We added around $10,000 in upgrades that we paid for out-of-pocket, which actually brought the purchase price to $156,500.

At the last minute, the builder asked us to do a lease option for a year to help him on his taxes, and we agreed as long as it did not affect our payment schedule for the agreed upon 15-year mortgage. We would have had 14 years left after the lease period at the same payment, as if we had a 15-year loan.

Everyone agreed. When we actually converted the lease to a loan, the builder applied all our payments to the principal and wrote up a new loan agreement for $132,597.88 for 15 years at 5 percent.

We now owe about $132,000 on a house that cost us $156,500 that weâ€™ve lived in for 17 months. We want to sell and can get about $170,000 for the house. This sales price would mean weâ€™d pocket a $13,500 profit, but the paper trail shows a $38,000 profit.

Where do we stand on capital gains taxes? And, what kind of exemptions are there, if any? We plan to downsize and start investing in real estate.

A: Unfortunately, the timetable for sheltering your capital gains on the sale of a primary residence is 2 years from the date of purchase. According to your letter, youâ€™ve only owned this property a little over a year.

To keep your profits tax-free, youâ€™d have to live in this house as your primary residence for two years after the date of closing. If you only live there for a year, youâ€™d owe long-term capital gains tax of up to 15 percent, plus state tax.

But there are some ways around the tax issue. If youâ€™re selling to take a new job thatâ€™s at least 50 miles from your old job, you should qualify to keep some of your profits tax-free, even if you havenâ€™t stayed in your home for 24 months. If you stayed a year before changing jobs, youâ€™d be able to keep up to $250,000 in profits (up to $125,000 if youâ€™re single), which is half of what youâ€™d ordinarily be able to take if you had lived there for two full years.

You could also claim the exemption if youâ€™re selling for medical reasons, a death, divorce, or fall into other special categories, as laid out by the IRS in Publication 523, â€œSelling Your House.â€•

If youâ€™re selling just to sell so you have cash to fund your investment property purchases, youâ€™ll have to pay the tax.

For more details, consult your accountant or tax preparer.

Q: My neighbors are about to move to Colorado. Their house has been on the market for a month. They found a house in Colorado already and will close at the end of the month. The company thatâ€™s relocating them will take over the sale of their house if it doesnâ€™t sell in 60 days.

Should we be concerned that the relocation company might sell this house for less than itâ€™s worth just to get rid of it? We plan to live here two or three more years. Weâ€™ve already been here for five years and have invested a lot in our property. We donâ€™t want the value of our home to go down because the house next door sold for less than it should have.

A: In a time when home sales are slowing in many neighborhoods, neighbor anxiety is on the rise. Many people are worryied about how their own home values will be affected by the way their neighbors choose to handle the sale of their houses.

First, you shouldnâ€™t speculate about what will happen in your local real estate market two or three years from now. Three years is a lifetime in the residential real estate world. Housing markets can change in a matter of weeks, and most of what happens (interest rates, local and regional economies) that can affect them is out of your control.

While itâ€™s possible the relocation company will dump the house if it doesnâ€™t sell quickly, thatâ€™s not very likely. Resale companies arenâ€™t in business to lose money, so itâ€™s more likely the house will simply sit on the market for an extended period of time. If there is a price reduction, it might be 5 percent or less.

However, letâ€™s say the resale company decides to drop the price by 20 percent to sell the house quickly. Itâ€™s likely that the actual resale price of the property would rebound fairly quickly once a new owner takes over. Any dip in neighborhood values would most likely be temporary.

The most important thing you can do is maintain your home and landscaping to the best of your ability â€¢ and let everyone know that the house next door is for sale!

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