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Valuable Information for Real Estate Professionals and their Clients

ANSWERS TO FAQ'S ABOUT THE 1997 PRIMARY RESIDENCE TAX LAWS (§121)

PRIMARY RESIDENCE RULES SUMMARY

Most real estate agents and brokers are familiar with the changes created by the 1997 Taxpayer Relief Act. This Act repealed the old §1034 rollover provision and one-time exclusion of \$125,000 at age 55. Although the revisions to §121 are a tremendous benefit to property owners, some frequently asked questions still need to be addressed. Let's review key elements of the new primary residence rules:

- Couples filing a joint tax return can exclude up to \$500,000 of the capital gain on the sale of their primary residence, and single filers can exclude up to \$250,000.
- The home must have been the primary residence of both spouses two of the last five years.
- The exclusion is available once every two years.
- Capital gains in excess of \$250,000/\$500,000 are taxed at the applicable tax rates (10% and 20% federal, plus state tax).

FREQUENTLY ASKED QUESTIONS (FAQ's)

- Q. Do the two years have to be consecutive?**
- A.** No, you can live in the property for one year and rent for one, then live there one year, etc.
- Q. What if I convert my primary residence to a rental for more than three years, can I take advantage of the tax exclusions under §121?**
- A.** Unfortunately not. The residence is no longer deemed a principal residence. You would be required to occupy it again for two years.

Q. Can the home be depreciated during the rental period and still qualify for the §121 exclusion?

A. Yes, however, depreciation taken after May 6, 1997 must be recognized in the year of the sale.

Q. If I convert my primary residence to a rental, how long does it have to be rented to qualify for a §1031 tax deferred exchange?

A. There is no definitive answer in the tax code that directly addresses this question. Under §1031, you may defer capital gain taxes when like-kind properties, which are "**held for investment**," are exchanged. Many tax and legal advisors believe that at least one (1) year of ownership is a reasonable minimum time frame. The owner must be able to support the fact that the home was legitimately converted to a rental that was "held for investment."

WHAT DOES THIS ALL MEAN? OPPORTUNITY!

1. Home owners ("empty nesters") can downsize without a huge tax penalty.
2. The potential exists for tax-free dollars to be used for the purchase of investment property.
3. Convert a vacation home into a primary residence and take advantage of the tax exclusion in 2 years.
4. Serial homebuyers! Buy and live in a "fixer home" for two years and keep the profit!



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