

A TWIST FOR HOME SALES -- NON-QUALIFIED USE

Since the advent of the home sale gain exclusion back in May 1997, taxpayers have been using the popular strategy to exclude gain, not just from their primary residence but also from rentals and second homes as well.

They do that by moving into the rental or second home and making it their primary residence for two years, then selling it and excluding the gain, up to \$250,000 (\$500,000 for joint filers).

To qualify for the exclusion, each taxpayer must own and occupy the home as their primary residence for two of the five years looking back from the sale date and must not have utilized the exclusion in the two years immediately preceding the sale. Thus, with careful planning, taxpayers could employ this technique on multiple properties.

However, in 2008 Congress enacted a provision to curtail gain exclusion attributable to periods of ownership when the property was not the taxpayer's primary residence. That law accomplished this by prorating the home sale gain between qualified and non-qualified use periods and allowing the home sale gain exclusion to apply only to gain from qualified periods.

Example: An individual taxpayer purchased a home on January 1, 2009 and used it as a second residence until January 1, 2011 when he occupied the property as his primary residence. He then sold the house on January 1, 2013 for a \$200,000 gain. Prior to 2008, the entire \$200,000 could have been excluded. However, after 2008, the taxpayer has to apportion the gain between the periods when it was a second residence and when it was a principal residence. In this example, he owned it four years, of which time, use for two years was non-qualified. Thus 50% of the gain (\$100,000) would be attributable to a non-qualified use period and would not be excludable. As a result, the taxpayer is able to exclude only \$100,000 of the \$200,000 gain. Note that had the taxpayer used the home as a rental instead of a second residence, the results would have been the same.

The law does provide a pretty liberal definition of non-qualified use. A period of non-qualified use means any period during which the property is not used by the taxpayer or the taxpayer's spouse or former spouse as a principal residence, except as noted below. For purposes of determining periods of non-qualified use, do not include:

- Any period before January 1, 2009 and
- The period that the taxpayer is temporarily absent by reason of health, change in place of employment or unforeseen circumstances (not to exceed 2 years).

If your planning strategies include employing multiple sales, each qualifying for the home sale exclusion, you should carefully analyze the impact of this twist on your plans.

Please call this office if you have any questions.