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HOME OWNERSHIP AND TAXATION
By: Jennifer L. Donohue, Esquire

I am sure that you have all completed and filed your 2001 income tax returns already (ha!) but in the spirit of the season, the following is a review of the major federal income tax provisions affecting homeowners.

1. Gain on Sale of Principal Residence

An individual may exclude from income up to $250,000 of gain on the sale of a residence. The individual must have owned and occupied the house as a principal residence for at least two of the five years (not necessarily two consecutive years) preceding the sale. The exclusion may not be used more frequently than once every two years. For married couples filing a joint return, the excludible gain is $500,000 if either spouse owned the property for at least two of the five years preceding the sale; both spouses used the property as their principal residence for at least two of the five years preceding the sale; and neither spouse has sold a principal residence within the past two years.

While most people are familiar with those rules, many are not aware that there is an exclusion amount (albeit a smaller one) available for individuals who fail to meet the specified tests. Therefore, this is not an all-or-nothing rule. For an individual who does not meet the two-year ownership and use requirements due to a change in place of employment, heath or "unforeseen circumstances" (a phrase yet to be defined by IRS regulations), a prorated exclusion amount is available.

It is also important to note there is an exception to the general rule for individuals who become incapacitated. Specifically, an individual who becomes physically or mentally incapable of self-care is deemed to use a residence as his or her principal residence during the time in which the individual owns the property and resides in a licensed care facility (i.e., a nursing home). In order for this rule to apply, the taxpayer must have owned and used the residence as a principal residence for one of the five years preceding the sale.

These rules have replaced the pre-1997 provisions which allowed the postponement of some or all of the gain from a principal residence if a new principal residence was purchased within two years of the date of the sale of the old residence. Similarly, the rules for post-May 7, 1997 sales have eliminated the code section which provided for a once-in-a-lifetime exclusion

from income of up to $125,000 of gain on the sale of a principal residence by an individual age 55 or older.

2. Deduction for Mortgage Interest

Deductible "qualified residence interest" includes interest that is paid or accrued during the tax year on home equity indebtedness (i.e., all debt that is secured by a residence to the extent that it does not exceed the fair market value of the residence). Interest on the debt is deductible even if the proceeds are used for otherwise non-deductible personal expenditures.

Begley & Begley P.C. is a law firm that concentrates on Estate & Tax Planning, Elder Law, Estate Administration, Guardianship and Will Contests, Real Estate, as well as Medicaid Planning. We are based in Moorestown, NJ, with offices in Avalon and Lawrenceville.

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If you are interested in having an Elder Law Attorney from Begley & Begley speak at an event, please contact Laura Dickens at (856) 787-4233.

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