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## An End to the Beach House Loophole?

By Elizabeth Razzi

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Investing in a vacation home would become a little less profitable under a tax change that may become law soon.

The immediate effect will be small, but the action serves as an important reminder for homeowners: Tax breaks can be taken away.

The change is part of a bill passed by the [House of Representatives](#) earlier this month that would end the government's kick-'em-when-they're-down treatment of people who lose their homes to foreclosure. Under current law, the federal government taxes people on the unpaid debt as if it were a cash gift bestowed by their lender.

The legislation also would make permanent the tax deduction for private mortgage insurance, which most homeowners have to pay if they made less than a 20 percent down payment.

Both pro-consumer measures draw cheers from practically all corners. But they would cut the government's tax intake, and so to pay for them, the House voted to close a loophole (and that's the word everyone uses for it) that has allowed some vacation-home owners to sell their beach house without paying capital gains tax.

Under current law, married homeowners can pocket as much as \$500,000 in capital gains from the sale of their principal residence without paying tax. (Taxpayers filing

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After Jan. 1, a new tax law is expected to apply to capital gains on the sale of a home, with particular consequences for vacation homes claimed as principal residences. Sellers may only qualify for a fraction of the current exemption. (By Robert A. Reeder -- The Washington Post)

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as singles can claim up to \$250,000.) To qualify, you must live in and own the home at least two out of the five years before the sale.

The tax break is not supposed to apply to a vacation home; any profit from that is supposed to be taxed as a capital gain, at a top rate of 15 percent. (That's slated to increase to 20 percent as of 2011.) Enter the loophole: Some tax-savvy owners figured out how to make it apply to the vacation home, too. They would sell their principal residence and take that gain tax-free. Then they would move into their vacation home and make it their principal residence for at least two years. Now they could sell that home, again with a tax-free gain.

The government wants its share, starting with homes sold after Jan. 1, 2008.

The version of the tax legislation working its way through the Senate does not include the vacation-home provisions, but because the major housing lobbying groups do not oppose closing the loophole, it would be a shock to see the Senate turn down the revenue.

So, what exactly would this mean to you and your house in [Rehoboth Beach](#)? In the short term, practically nothing. As time passes, however, the phasing-in of the new rules would cause some owners' tax bills to rise significantly.

Here's how it would work, according to Linda Goold, tax counsel for the [National Association of Realtors](#).

For homes sold after Jan. 1, sellers would have to calculate a fraction. The top number would be the number of years the home was your principal residence. The bottom number would be the number of years, starting Jan. 1, that you owned the home. That fraction would determine the share of that \$500,000/\$250,000 tax break you can claim.

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