

New Math for Selling Second Homes

By Benny L. Kass
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If you are planning to sell your vacation home in the next few years, you might want to move in and treat it as your principal residence as soon as possible. This summer's housing stimulus legislation changed a tax law that could affect you.

Under current law, if you move into your second home that you have been renting out for many years and live in it for two of the five years before you sell it, you can exclude from taxation up to \$250,000 of any gain you make. (If you are married and file a joint tax return, the exclusion is up to \$500,000.)

But Congress -- in an effort to offset other costs of the new law -- targeted tax treatment of second homes, which includes vacation homes and rental property.

Effective for property sales after Jan. 1, you will have to allocate the percentage of time that you owned the property as compared with the time it was not used as your principal residence. You will need to crunch the numbers to determine any possible tax liability.

Let's look at some examples:

· On Jan. 1, you buy a vacation home for \$500,000. Two years later, you decide to move in and treat it as your principal residence. On Jan. 2, 2014, you sell it for \$800,000, giving you a profit of \$300,000. You are single, so under the old law you could have excluded \$250,000 of this gain from taxation. Thus, you would have had to pay capital gains tax on the remaining \$50,000, which at the current 15 percent rate would set you back \$7,500.

However, under the new law, you have to determine the number of years after 2009 that the house was not used as your principal residence. In this example, the formula is:

Number of non-residential years: two (2009-10)

Number of ownership years: five (2009-13)

Your non-excludable gain is \$120,000 (Two divided by five; then two-fifths of \$300,000). If the capital gains tax rate remains the same, you would owe the IRS \$18,000.

But that's not the end of the calculation. Remember that you can still exclude up to \$250,000 of your gain for the period that the house was your principal residence. Your excludable gain in this example is \$180,000 (\$300,000 minus \$120,000), and thus no additional tax is owed.

As you can see, under the new law, this transaction would cost you \$10,500 more than you would owe under the old law.

· On Jan. 1, 1995, you and your husband bought a property for \$100,000. You continuously rented it out. However, on Jan. 1, 2013, you move into the house and use it as your principal residence. On Jan. 2, 2015, you sell it for \$900,000. Over the years, you made \$100,000 in improvements. Your total gain would be \$700,000 (\$900,000 minus \$200,000). Under the old law, because you lived in the house for two of the five years before sale, you could exclude \$500,000 of your gain. You would owe capital gains tax on the remaining \$200,000. At the current 15 percent tax rate, this would be \$30,000.

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However, under the new law, you have to determine the number of years after 2009 that the house was not used as your principal residence. In this example, the formula is:

Number of non-residential years : five (2009-13)

Number of ownership years: 20 (1995-2015)

Your non-excludable gain is \$175,000 (five divided by 20, then multiplied by \$700,000). If the capital gains tax rate remains the same, you would owe the IRS \$26,250.

Once again, that's not the end of the calculation. The remaining excludable gain in this example is \$525,000 (\$700,000 minus \$175,000). Accordingly, you would also have to pay tax on the \$25,000 that exceeds your \$500,000 exclusion. At 15 percent, that's \$3,750. So your total bill on the transaction would be \$30,000.

Why is the total for this example the same under the old and new formulas? The longer you own your house, the less impact the new law will have. Additionally, the more profit you make, the less impact there will be. Even under the old law, once your profit exceeds the statutory caps (\$250,000 or \$500,000), you have to pay capital gains tax.

In our examples, we did not include tax obligations to local and state governments, nor did we take into consideration such deductible expenses as real estate commissions. Additionally, if you depreciated your rental property, you might have to pay a recapture fee of 25 percent.

This is extremely complex. If you own properties that might ultimately become your principal residence, you should consult your tax and legal advisers as soon as possible.

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Sellers left high and dry as housing prices slide

By AL KEMP The News Journal
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MIDDLETOWN -- Dave Wisniewski paid \$415,000 for his four-bedroom home on East Kilts Lane in the Estates at St. Anne's last year.

Around the corner, a house on Scottish Drive that sold for \$474,900 the year before has been back on the market for five months. The current asking price is \$349,900.

"The market will turn around eventually," Wisniewski said. "I'm going to be here a long time."

But for people trying to sell their property now, recent news has not been good.

The collapse of the subprime mortgage market in the United States led to financial firms around the world reporting hundreds of millions of dollars in credit-market losses and writedowns.

Then came the government takeover of mortgage giants Fannie Mae and Freddie Mac, the collapse of investment bank Lehman Brothers, the Fed's \$85 billion takeover of AIG, Bank of America swallowing Merrill Lynch and Thursday night's rescue by JPMorgan Chase & Co. of thrift bank Washington Mutual.

Congress is trying to come to the rescue, debating a \$700 billion bailout plan that would infuse banks with money and loosen lending.

In the meantime, sellers such as those on Scottish Drive are struggling to find buyers even as they slash asking prices, and potential buyers are facing more scrutiny, often needing higher credit scores and down payments to qualify for a mortgage.

About four miles to the east of St. Anne's, in Appoquin Farms, Linda McCormick has been trying to sell her home for 15 months.

She has cut her asking price by \$25,000, but so far she has had nothing but mild inquiries. The four-bedroom Colonial is in pristine condition, but with each passing month, she grows more frustrated.

"It's real easy to get optimistic and get your hopes up when someone comes back for a second look, but then the balloon pops. It's just very, very frustrating," she said.

Denise Freeman, a housing counselor, helps first-time buyers and others with credit issues obtain a mortgage.

"It's a roller coaster right now. It's very challenging for people who are still working towards home ownership. It's difficult to even tell them which way to go anymore," Freeman said.

Wisniewski and McCormick are examples of how the sub-prime-mortgage failure has brought Wall Street's problems to Main Street.

For a picture of the real estate market in its most volatile mood, observers point to southern New Castle County. A torrent of rapid growth in the past decade turned former fields of corn and soybeans into vast residential tracts with commuter traffic clogging roads around once-quiet Middletown.

Appoquinimink became the fastest-growing school district in the state, opening about a new school a year. Population in the school district, just over 20,000 in 1995, is projected to pass 66,000 by 2015.

But the downturn appears to have ended that.

Today, home sales -- and home prices -- are down statewide and the number of days a property spends on the market is up sharply. It is harder than ever to get a mortgage.

"It's scary that the same lending criteria that was sufficient two years ago are not today," Freeman said.

The Washington-based Mortgage Bankers Association's weekly loan survey, released Wednesday, shows mortgage

applications in the U.S. fell last week as higher borrowing costs and tougher lending rules hurt purchases and refinancing.

Mortgage rates rose even as yields on U.S. Treasury securities dropped, reflecting the tightening of credit that prompted the federal takeover of AIG and brought down Lehman Brothers.

The average rate on a 30-year fixed-rate loan rose to 6.08 percent from the prior week's five-month low of 5.82 percent, the report showed.

"Housing will stay weak," said Scott Anderson, a senior economist at Wells Fargo & Co. in Minneapolis. "As the economy slows the rest of the year, it is hard to imagine people will be in a mood to buy a home."

There were about 2,800 foreclosures statewide in 2006. Through the second quarter of 2007, owners of more than 2,500 mortgage loans had filed for foreclosure, according to the interim report of Lt. Gov. John Carney's Foreclosure Task Force.

New Castle County recorded 1,629 foreclosure filings in the first eight months of 2008, said Christina Hardin of the Delaware State Housing Authority.

Nearly 10 percent of those filings -- 150 homes -- had addresses in Middletown's 19709 ZIP code, and the neighborhood that appears most often is Middletown Village, a subdivision of more than 1,000 housing units off U.S. 301 that comprises single-family homes, town homes and apartments (other Middletown neighborhoods mentioned more than once in the foreclosure documents: The Legends, Estates at St. Anne's, Dove Run and Willow Grove Mill).

"Middletown Village started out as one of the affordable communities here," said Betty Lou Griffith of Patterson Price Real Estate, with offices on Main Street in Middletown. "Their town houses started around \$79,000."

Today, some are listed for more than \$200,000.

Susan Love, 33, bought her town home in Middletown Village in 1999. She considers herself one of the lucky ones who got in early.

"My mortgage is very low," said Love, former president of the now-idle Middletown Village Civic Association. "It's the people who bought in the last two or three years that are trapped."

In Middletown, as in the rest of the state, a surplus of houses and shortage of buyers is a textbook lesson in supply and demand, said Will Webber, a Keller Williams Realtor.

"What happened in the last four years is oversupply. And when you have oversupply, prices go down," said Webber, who was a site agent or builder's representative for several of the midstate region's established neighborhoods north of Middletown.

There are 533 homes for sale in New Castle County south of the Chesapeake & Delaware Canal, said Bob Weir of the New Castle County Board of Realtors. Two years ago at this time, 129 were for sale.

Of those 533 homes, the average number of days on the market is 134, three times longer than the average a year ago.

Statistics like those leave home sellers a bit like dieters stepping onto a bathroom scale.

"They're afraid of the numbers they'll see," Webber said.

Webber said he's brokered some settlements in which the seller wound up writing the settlement check because of a refinancing appraisal made before a market decline.

Some families have decided to stay put for fear of financial peril -- "especially if they refinanced the hell out of their house," he said.

The shortage of buyers has forced Webber to adjust his methods. He developed a new cold-calling pitch and a copyrighted lawn sign that says, "YARD SALE, HOME INCLUDED."

In midstate, part of the problem also is what is on the market.

There's a certain type of home that proliferates south of the Chesapeake & Delaware Canal. Webber is not afraid to say it: "McMansions."

"A 'McMansion' is a super-sized house built on a relatively small lot, which buyers can customize," he said. "Just like fast food, where the buyer will substitute onion rings for French fries, they'll say, 'I want the sunroom instead of the finished basement.' "

Sales in a typical McMansion neighborhood are brisk at first, Webber said, but just when the neighborhood is about two-thirds built out, sales slow to a trickle and market forces drive down prices.

"Now the builder is selling at or near cost, just to make the monthly payments on a cornfield," he said. "So the same houses that used to be \$450,000 are now on sale for \$375,000."

There are now 38 new single-family homes on the market in Smyrna in the "McMansion" price range -- \$350,000 to \$650,000. They're in such neighborhoods as Huntfield, Lake Como Woods and Jockey Hollow.

Middletown has even more "McMansions" -- 82 at the moment, in neighborhoods such as Back Creek, Lorewood Estates and Willow Grove Mill.

One problem with "McMansions," according to real estate agents, is that owners often sink too much of their wealth into them.

Looking for a home big enough for them and their four children, Torie and Bruce Baker chose the neighborhood of Townsend Village II about two years ago.

They spent about \$400,000 for a four-bedroom Colonial on Ginn Street.

Around the same time as the Bakers moved in, a four-bedroom home just around the corner on Karins Boulevard went on the market for \$449,000. The price was cut to \$419,900 and later to \$399,900. It finally sold last month for \$314,000, after 480 days on the market.

"The people who are now trying to buy homes can get them for less than their neighbors paid," Webber said.

"I don't think anyone around here can move out and not lose money," Torie Baker said. "I think we're going to have to ride it out."

Realtors say the Bakers are not alone. Homeowners everywhere are biding their time, they say.

"In some cases, they are now owing more money to the lender than the house is worth," Griffith said. "Even if they wanted to move, they could not."

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Existing-Home Sales Fall 2.2 Percent

WASHINGTON (Sept. 24) - Sales of existing homes fell in August, but the number of unsold homes on the market also dropped sharply from the previous month's record high.

The National Association of Realtors said Wednesday that sales fell 2.2 percent to a seasonally adjusted annual rate of 4.91 million units, from an upwardly revised pace of 5.02 million in July. Sales had been expected to fall by 1.6 percent, according to economists surveyed by Thomson/IFR.

There were 4.3 million unsold homes on the market, a 7 percent drop from the record set in July. It was the steepest drop in inventory since December 2006. At the current sales pace, it would take 10.4 months to sell all the properties.

Until the inventory level is reduced to more normal levels, analysts say, the housing slump is likely to persist. Inventories are being driven higher by a massive wave of mortgage foreclosures.

"We hope the downward trend in inventories continues," said Lawrence Yun, the trade group's chief economist. "Home prices will not stabilize as long as inventories remain high."

Median prices - the point at which half of the homes sold for less and half for more - fell 9.5 percent from a year ago to

\$203,100, the largest price decline on records dating to 1999. Sales were 10.7 percent below last year's levels.

The national decline in home values coupled with shaky lending standards during the real estate boom are the driving forces behind rising mortgage defaults and foreclosures. They have spurred a credit crisis that has shaken Wall Street to its core and caused the Bush administration to propose a \$700 billion financial industry bailout.

Yun said the trade group is sending a letter to Congress in support of the rescue plan. While buyers are pouncing on lower prices - especially in places like California, Florida and Nevada - sales are sluggish in formerly stable markets like the Pacific Northwest and Charlotte, N.C., he added.

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