

## The spouse who leaves the family home can still get a \$250,000 exclusion from capital gains taxes.

Before the Tax Relief Act 1997 (TRA '97), if one spouse left the house two years before the divorce was final, they lost their ability to roll forward their capital gain. In cases where there is significant capital gain in the family home, TRA '97 allows both spouses to take a \$250,000 exclusion even though one spouse is awarded the house.

Exclusions allowed under TRA '97 include:

- Single taxpayers can exclude \$250,000 from capital gains
- Married filing jointly can exclude \$500,000 from capital gains
- These exclusions are allowed for one sale every 2 years
- The selling spouse must have lived in the house at least 2 out of the last 5 years. (Change in place of employment, health or unforeseen circumstances allow an exception)

### **Ownership test**

If one spouse, pursuant to a divorce decree or separation agreement is required to grant the other spouse the right to temporary possession of the home, but retains title to the home, and the home is later sold, the non-occupying spouse will be treated as having owned the home for the period of time that the occupying spouse owned the home as principal residence.

### **Use Test**

In the event one spouse transfers a residence to the other pursuant to a divorce decree, the “transferring spouse” shall be able to include the “receiving spouse’s” use period in computing their own use period.

### **Note**

If one or the other remarries prior to sale of home jointly owned with the former spouse, the remarried spouse can use the new spouse’s time in the home to meet residency requirements to use the “married filing jointly” exclusion amount.

Let's look at an example:

John and Mary are getting divorced. Under the divorce decree, Mary is awarded the jointly owned family home for six years until their son graduates from high school. At the end of six years, Mary will sell the home and 50% of the proceeds will be sent to John.

Mary sells the home for \$750,000. Mary and John will each receive \$375,000. If the basis in the property was \$100,000, Mary's portion of the basis is \$50,000 leaving her with \$325,000 gain. Even though she uses her \$250,000 exclusion, she will be taxed on \$75,000 of gain.

<b>\$750,000</b>	Sales price	<b>\$750,000</b>	Sales price
<b>- 100,000</b>	Basis	<b>375,000</b>	John's half
<b>\$650,000</b>	Capital gain	<b>375,000</b>	Mary's half

What if, in the 2nd year, Mary marries Bill and he has lived in the house for four years before she sells it? Bill can also take an exclusion, which would reduce the capital gains taxes to zero for everyone.

<b>Mary</b>		<b>John</b>
\$375,000	half of Sales Price	\$375,000
<u>- 50,000</u>	half of Basis	<u>- 50,000</u>
\$325,000	Half of Capital Gain	\$325,000
<u>-250,000</u>	Exclusion	<u>-250,000</u>
\$75,000	Amount each will be taxed on	\$75,000

For this to work, both Mary's and John's names have to stay on the deed so that the IRS knows that John is entitled to his exclusion. This arrangement also has to be stated in the divorce decree. (Bill gets his exclusion because he is married to Mary and has lived in the house for 2 out of the past 5 years before the sale.)

Are you ready for this? What if Mary marries Bill, and they live in the house for 3 years, after which they move into their dream home. Then, John who has married Sara, moves back into the house with Sara for the remaining 3 years before the house is sold. At the time of sale, Sara has also lived in the house for 2 out of the past 5 years before the sale and if needed, could also exclude \$250,000!!

One good thing that the law gave us is that this is not a one-time exclusion. We can use it over again every two years. So each time we buy a house and sell it after two years, we can use the exclusion.