PacificCPE

COURSE
30902C

Financial Planning: Home Sales, Rental Property, and Mutual Funds

Clients frequently ask about selling a home, renting out property, or investing in mutual funds—and the tax rules in each area have plenty of nuance. This course walks through gain and loss calculations on home sales, the principal residence exclusion, vacation home rules, depreciation on rental property, and the safe harbor election for small taxpayers. It also covers mutual fund distributions, fee structures, tracking basis, and handling sales and redemptions. If you regularly advise clients on real estate or investment accounts, this course delivers directly applicable guidance.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

Start Course ↓ | Final Exam Copy ↓

LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize the tax rules that apply when an individual sells his or her home.
- Identify some of the tax implications of owning a second home, whether or not for rental purposes.
- Recall the rules that govern the taxation of distributions from mutual funds.

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Chapter 1: SALE OF A HOME

Chapter Objective

After completing this chapter, you should be able to:

- Recognize the tax rules that apply when an individual sells his or her home.

I. INTRODUCTION AND OVERVIEW

For most Americans, the largest investment anyone will ever have is their home. It is therefore essential that accountants be able to advise their clients on the various tax implications of selling a home. This chapter explains the tax rules that apply when an individual sells his or her main home.

II. MAIN HOME

This section explains the term “main home.” Usually, the home an individual lives in most of the time is his or her main home and can be a:

- House;
- Houseboat;
- Mobile home;
- Cooperative apartment; or
- Condominium.

To exclude gain, an individual generally must have owned and lived in the property as his or her main home for at least two years during the five-year period ending on the date of sale.

A. SALE OF LAND ONLY

If an individual sells the land on which his or her main home is located, but not the house itself, he or she cannot exclude any gain he or she has from the sale of the land. However, if the individual sells vacant land used as part of his or her main home, and that is adjacent to it, the individual may be able to exclude the gain from the sale under certain circumstances.

Example

Bill buys a piece of land and moves his main home to it. Then he sells the land on which his main home was located. This sale is not considered a sale of Bill's main home, and he cannot exclude any gain on the sale of the land.

B. MORE THAN ONE HOME

If an individual has more than one home, he or she can exclude gain only from the sale of his or her main home. A taxpayer must include in income the gain from the sale of any other home. If an individual has two homes and lives in both of them, his or her main home is ordinarily the one he or she lives in most of the time during the year.

Examples

Example 1. Lisa owns two homes, one in New York and one in Florida. From 2022 through 2026, Lisa lives in the New York home for 7 months and in the Florida residence for 5 months of each year. In the absence of facts and circumstances indicating otherwise, the New York home is Lisa's main home. She would be eligible to exclude the gain from the sale of the New York home but not of the Florida home in 2026.

Example 2. Connie owns a house, but she lives in another house that she rents. The rented house is Connie's main home.

C. PROPERTY USED PARTLY AS MAIN HOME

If an individual uses only part of the property as his or her main home, the rules discussed in this chapter apply only to the gain or loss on the sale of that part of the property.

III. FIGURING GAIN OR LOSS

To figure the gain or loss on the sale of an individual's main home, the owner must know the selling price, the amount realized, and the adjusted basis. Subtract the adjusted basis from the amount realized to get the individual's gain or loss.

A. SELLING PRICE

The selling price is the total amount an individual receives for his or her home. It includes money, all notes, mortgages, or other debts assumed by the buyer as part of

the sale, and the fair market value of any other property or any services the seller receives. In some cases, an individual may have to sell his or her home because of a job transfer. If an employer pays an employee for a loss on the sale or for his or her selling expenses, the seller should not include the payment as part of the selling price. Rather, the employer will include the amount paid as wages in box 1 of your Form W-2, and the individual will include it in his or her income on Form 1040 or 1040-SR, line 1.

1. Option to Buy

If a buyer pays for an option to buy and later exercises the option, the amount received by the seller for the option must be added to the selling price of the home. If the option is not exercised, the seller must report the payment as ordinary income in the year the option expired. This income is reported on Schedule 1 (Form 1040), line 8z.

B. AMOUNT REALIZED

The amount realized is the selling price of the home minus selling expenses. Selling expenses include all of the following:

- Commissions;
- Advertising fees;
- Legal fees; and
- Loan charges paid by the seller, such as loan placement fees or “points.”

C. ADJUSTED BASIS

While the seller owned his or her home, the seller may have made adjustments (increases or decreases) to the basis. If so, this adjusted basis must be determined before the seller can figure gain or loss on the sale of the home.

D. AMOUNT OF GAIN OR LOSS

To figure the amount of gain or loss, the amount realized is compared to the adjusted basis. If the amount realized is more than the adjusted basis, the difference is a gain and, except for any part the seller can exclude, generally is taxable. If the amount realized is less than the adjusted basis, the difference is a loss. A loss on the sale of an individual’s main home cannot be deducted.

1. Jointly Owned Home

If an individual and his or her spouse sell their jointly owned home and file a joint return, they will calculate their gain or loss as one taxpayer.

a. Separate Returns

If a seller files a separate return from his or her spouse, each spouse must calculate his or her own gain or loss according to his or her ownership interest in the home. Each spouse's ownership interest is determined by state law.

b. Joint Owners Not Married

If two owners who are not married sell their jointly owned home, each must calculate their own gain or loss according to their ownership interest in the home.

E. OTHER DISPOSITIONS

The following rules apply to foreclosures and repossessions, abandonments, trades, and transfers to a spouse.

1. Foreclosure and Repossession

If an individual's home was foreclosed on or repossessed, the owner is treated as having a disposition. The owner will figure his or her gain or loss in generally the same way as a normal sale. However, the amount of the gain or loss depends, in part, on whether the owner was personally liable for repaying the debt secured by the home.An individual also may realize ordinary income from cancellation of debt if the loan balance is more than the fair market value of the property.

2. Nonrecourse Debt

If an individual is not personally liable for repaying the debt (nonrecourse debt) secured by the transferred property, the amount they realize includes the full debt canceled by the transfer. The full canceled debt is included even if the fair market value of the property is less than the canceled debt.

Examples

Example 1. Chris bought a new home for $150,000. He paid $20,000 down and borrowed the remaining $130,000 from a mortgage lender. Chris is not personally liable for the loan (nonrecourse), but pledges the new home as security. The lender repossessed the home because he stopped making loan payments. The balance due after taking into account the payments Chris made was $100,000. The fair market value of the home when repossessed was $99,000. The amount Chris realized on the repossession is $100,000. That is the debt canceled by the repossession, even though the home's fair market value is less than $100,000. Chris figures his gain or loss on the repossession by comparing the amount realized ($100,000) with his adjusted basis ($150,000). He has a $50,000 nondeductible loss.

Example 2. Abena paid $200,000 for her home. She paid $15,000 down and borrowed the remaining $185,000 from a bank. Abena is not personally liable for the loan (nonrecourse debt), but pledges the house as security. The bank foreclosed on the loan because Abena stopped making payments. When the bank foreclosed on the loan, the balance due was $180,000, the fair market value of the house was $170,000, and Abena's adjusted basis was $175,000 due to a casualty loss she had deducted.

The amount Abena realized on the foreclosure is $180,000, the debt canceled by the foreclosure. She figures her gain or loss by comparing the amount realized ($180,000) with her adjusted basis ($175,000). She has a $5,000 realized gain.

3. Recourse Debt

If an individual is personally liable for the debt (recourse debt), the amount realized on the foreclosure or repossession does not include the canceled debt that is the individual's income from cancellation of debt. However, if the fair market value of the transferred property is less than the canceled debt, the amount realized includes the canceled debt up to the fair market value of the property. The owner is treated as receiving ordinary income from the canceled debt for the part of the debt that is more than the fair market value.