Tax Impacts of Buying, Selling

Real estate transactions are significant financial undertakings that can have profound tax implications for buyers and sellers alike.

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Understanding the tax nuances associated with buying or selling a property allows everyone to make informed decisions and optimize financial outcomes.

DEDUCTIONS FOR HOMEBUYERS

For prospective homebuyers, there are several potential tax deductions that can help alleviate the financial burden of purchasing a property. The most notable deduction is the mortgage interest deduction. Homeowners can deduct the interest paid on their mortgage, up to a certain limit, from their taxable income. Additionally, property taxes paid on the home may also be deductible.

First-time homebuyers may qualify for special deductions or credits. The First-Time Homebuyer Credit ended in 2010, but there is a bill before Congress to revive the credit with different criteria, according to Bankrate.com.

DEDUCTIONS FOR SELLERS

Some of the expenses of selling a home and preparing it for sale can be deducted from the sales price of your home, which will lower your capital gains tax. According to Realtor.com, you can deduct home staging fees and sales costs.

"You can deduct any costs associated with selling the home — including legal fees, escrow fees, advertising costs and real estate agent commissions," Joshua Zimmelman, president of Westwood Tax and Consulting, told Realtor.com.

However, the home must be a home that you actually live in as your primary residence. Home improvement costs incurred to sell the house are only deductible if they were made within 90 days of closing.

CAPITAL GAINS TAX ON PROPERTY SALES

When selling a property, capital gains tax comes into play. Capital gains are the profits made from the sale of an asset, and they can be categorized as either short-term or long-term, depending on the holding period. Real estate is unique in that it enjoys favorable treatment when it comes to capital gains tax.

Homeowners can exclude a certain amount of capital gains from the sale of their primary residence from taxable income. According to the Internal Revenue Service, sellers can exclude a maximum of $250,000 for individuals and $500,000 for married couples filing jointly. To qualify, the homeowner must have owned and used the property as their main residence for at least two of the five years leading up to the sale.

Be aware of the potential for capital gains tax if the property has been used for purposes other than a primary residence or if the exclusion criteria are not met. In such cases, the gains may be subject to taxation at the applicable capital gains rates.

Keep in mind that capital gains are calculated based on the cost basis of your home, not on the price you originally paid for it. Any money spent to improve the home is added to what you paid for it before determining what the gains are.

1031 EXCHANGES

For real estate investors looking to defer capital gains tax, a 1031 exchange provides a valuable option. This provision allows investors to sell a property and reinvest the proceeds into a like-kind property, deferring the capital gains tax until a future sale. It is crucial to adhere to strict IRS guidelines to qualify for the benefits of a 1031 exchange.

TAX CREDITS FOR ENERGY-EFFICIENT UPGRADES

Homeowners may also qualify for tax credits by making energy-efficient improvements to their properties. The Residential Renewable Energy Tax Credit, for instance, provides a credit for the installation of solar panels, geothermal heat pumps and other qualifying renewable energy systems. These credits contribute to a greener planet and offer financial incentives for homeowners.

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REAL ESTATE 101

Mortgage Tip

Apartment Therapy has some advice for people who don't have great credit. Use a mortgage broker instead of a bank or credit union. The broker will have access to more types of loans and gets paid only if you are able to get a mortgage.

HOMEWISE GLOSSARY

Encroachment: an obstruction, building, or part of a building that intrudes beyond a legal boundary onto neighboring private or public land, or a building extending beyond the building line. **SOURCE**: Illinois Real Estate Lawyers Association