

Taxes on Selling a House

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Selling a home is a major life change. Maybe you're moving into a bigger house after outgrowing your starter home, or you're downsizing as your kids go off to college. Or, perhaps, you're buying a house in a different part of the country because of a new job. No matter what your reason is, selling the place you've called home is a big deal. One potentially confusing part of the process is figuring out the taxes on selling a house and how the sale will impact your finances for the years to come.

This guide will explain what you need to know about the taxes on selling a house. It will explore tax breaks, reduced exclusions, how to report your house sale on a tax return and how to determine the total profit of your home sale. Talking to a financial advisor before you sell your house may be a good idea.

Do You Have to Pay Taxes on Selling a House?

When you sell your house, you might have to pay taxes on the money you earn from the sale. However, there are exceptions that may result in you paying very little or even nothing at all in taxes.

If you've lived in your house for two of the five years directly before the sale, the first \$250,000 of any profit you make on the home is tax-free. The tax-free amount increases to \$500,000 if you are married and you and your spouse file a joint tax return. It's important to note that this is the first \$250,000 (or \$500,000) of profit, not income. This means that the tax is based on the net amount (after expenses) that you gain from selling your house, not on the total amount of money you make from selling your house.

If you sell your home for less than \$250,000 more than your buying price – and you've lived in your house for at least two of the previous five years – you won't owe any taxes on the sale of your home.

How to Determine the Profit on Your Home Sale



This means, of course, that you'll need to calculate the profit you've made from selling your home in order to determine if you'll owe taxes on the sale of your home. This calculation isn't as simple as subtracting the price you paid from your sale price though.

First, you'll need to figure out the cost basis for your home. You'll need to consider not only the total amount you spent to purchase the house but also how much you've spent on any additions or home improvements. So, for example, let's say your original purchase price was \$200,000 and you spent \$20,000 on adding an extra room. You'll then add \$20,000 to your cost basis.

Next, take note of how much you sold your home for. You'll then subtract any fees you paid, such as closing costs and realtor fees, from that amount. If you sold your home for \$300,000 but paid \$10,000 in fees, the total amount you earned on the sale of your home is \$290,000.

Now, subtract your cost basis from the total amount of money you earned from the sale. In this case, that's \$290,000 minus \$220,000, resulting in a profit of \$70,000. Since that amount is less than \$250,000, you wouldn't owe any taxes on this home sale.

How to Qualify for Home Selling Tax Breaks

There are three basic requirements you must meet to qualify for the above tax break:

- You must have owned the home you are selling for at least two years. If you've owned the home for less time, you do not qualify for the tax break.
- You must have used the home as your primary residence for at least two of the past five years. This means that second homes, such as vacation homes and pure rental properties, will likely not qualify for this tax break.
- You must not have used this tax break for the sale of another home within the past two years. This means that if you are trying to sell multiple properties, the tax break can only apply to one of your properties.

If you meet these three qualifications, then you are eligible for the tax break.

Qualifying for a Reduced Exclusion

A reduced exclusion allows you to claim part of the tax break, even if you don't meet all of the above requirements. If you have only lived in your home for one year, for instance, you could be exempt for just \$125,000 of any profit you make from selling your home.

You must have a valid reason to qualify for a reduced exclusion though. Valid reasons include changes in employment, changes in health or any other unforeseen circumstance that makes it necessary for you to sell your home sooner than anticipated.

Reporting the Sale on Your Tax Return



If your profit on your home sale is less than the exemption amount and you meet the other qualifications, you do not have to report your home sale on your tax return. If you do exceed the exemption or you don't qualify for it, however, you will need to report your home sale. Any profit that exceeds or does not qualify for the exemption is taxed as a capital gain under Schedule D.

You will also need to report your home sale if you receive a Form 1099-S. This form is distributed when you make a home sale unless you assure your real estate closing company that you will not owe taxes on your profit.

If you receive a form even though you qualify for the exemption, this doesn't necessarily mean you owe taxes. However, it does mean that you will have to report the sale.

The Bottom Line

While it's possible you'll have to pay taxes on the sale of your home, chances are you won't have to. If you meet a few simple requirements, up to \$250,000 of profit on the sale of your home is tax-free. This figure jumps to \$500,000 if you are a married couple filing jointly. In fact, if you don't owe taxes, you don't even need to list your home sale on your tax return. Any taxed profit falls under the capital gains guidelines.

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