How Much Will I Be Taxed When Selling My Home?

By: Exchange Capital Management

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Deciding to sell your home and embark on a new chapter in life can be an overwhelming experience. Whether you're downsizing for retirement, relocating closer to family, or simply craving a change of scenery, it's important to consider the potential tax implications that follow the sale of a home.

Selling your home for more than you bought it for can trigger capital gains tax. How much you will be taxed depends on your annual income, tax filing status, how long you owned the home, and if the house is your primary residence.

Capital Gains Tax

Only the profit from the sale is taxable. To calculate the taxable amount, subtract the adjusted cost basis from the final selling price. The adjusted cost basis is the original purchase price of the house adjusted for closing costs, deductions, and/or major renovations.

For example, if you purchased the house for $225,000 and then did a $25,000 kitchen renovation, your adjusted cost basis is $250,000. If you sell the house for $500,000, you'll have a $250,000 realized gain that can trigger either short-term or long-term capital gains tax.

> **Short-term Capital Gains:** If you've owned the house for a year or less, it's considered a short-term capital gain. Short-term gains will be taxed at your ordinary income tax rate, ranging from 10% to 37%. This rate depends on your annual ordinary income.

Long-term Capital Gains: If you've owned the house for over a year, then it qualifies as a long-term capital gain. Long-term gains qualify for lower tax rates, ranging from 0% to 20%. This rate is based on your total taxable income in a given year.

Some homeowners may sell the house for less than their adjusted cost basis, resulting in a capital loss. Generally, when you sell an investment at a capital loss, you can deduct that loss from your taxable income for that year. Unfortunately, your primary residence does not qualify for this deduction since it is considered a "use" asset, not an investment. Deductions for losses can only be claimed for rental and investment properties.

Home Sale Tax Exemption

The IRS provides exemptions for capital gains tax when selling your primary residence. Single filers can exclude up to $250,000 of capital gains and married couples filing jointly can exclude up to $500,000.

To qualify, you must meet all the following IRS requirements:

- Owned the home for at least two years
- It must be your primary residence for at least two of the past five years
- You haven't used the tax exclusion for the sale of another home within the last two years
- You didn't acquire the property through a like-kind exchange in the past five years
- You aren't subject to expatriate tax
- You didn't use the property as a vacation or rental home after 2008, or you didn't use a portion of the home, outside the living area, for business or rental purposes
- The sale doesn't involve the transfer of vacant land or a remainder trust

If you don't meet all these requirements, you may still qualify for a reduced exclusion if you had a change in employment, health issues, or any unforeseeable event that forced you to sell your home sooner than expected.

If the capital gains from the home sale exceed the exclusion limit, you'll have to pay capital gains tax on the excess amount. For example, a single tax filer who qualifies for the $250,000 exclusion and sells their house with a $300,000 capital gain would have to pay capital gains tax on the $50,000 excess profit.

State Tax

You could be subject to state income tax when selling a house. If you're completely exempt from federal capital gain taxes due to the exclusion—you shouldn't have to worry about state income taxes. However, if the exemption amount doesn't fully cover your capital gain, you may also owe state taxes on the profit. If and how you'll be taxed will vary from state to state.

Some states and counties may levy real estate transfer taxes. Whether you're charged a transfer fee and how much you'll be charged depends on where you are selling the house. The good news is you may be able to include the transfer fees in your adjusted cost basis to minimize your capital gains tax liability. Always research your state's tax rules to understand how selling a property can affect your taxes.

The Bottom Line

While selling your home is a taxable event, many individuals qualify for the home sale tax exclusion. If you don't qualify for the exclusion or you're selling a home that is not considered your primary residence—like a vacation home or rental property—you'll be expected to pay capital gain rates on the profit made from the sale.