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Yours to keep

* The law allowing tax-free gains on most home-sale profits entices some to sell, but many remain unaware that they can take the money and run.

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Like many people, Augusta Solursh hasn't necessarily kept up on tax law.

So when the 86-year-old widow sold her Hancock Park condo in February, she got a tax-free bonus she didn't expect.

Solursh, who had owned her condo since 1983, sold to move to a rental in Park La Brea, an area convenient to shopping, friends and where, she said, "all the activity is in Los Angeles." Her motivation: "I moved because it was time to change."

The move proved a boon to her financial portfolio. Solursh sold her condo for \$325,000, realizing a net profit of \$180,000. Her entire gain was tax-free.

One of the best tax breaks around isn't supposed to be a secret, but many homeowners remain unaware of the windfall that could await them due to a law Congress passed in 1997.

"It's stunning how many potential sellers -- and even a few brokers -- don't know this law exists," said Bill Hoff, a Realtor with Coldwell Banker in South Laguna. The revised Internal Revenue Code states that if you have owned and lived in your primary residence for a total of two of the past five years, you qualify for up to \$250,000 in tax-free profits. Couples can take as much as \$500,000 in tax-free profits.

"There's nothing else like it from a tax-savings standpoint," said Mark Yegsigian, certified public accountant and owner of Mission Tax & Financial, in Laguna Hills. "If you qualify, jump on it like there's no tomorrow."

Before Congress revised IRC 121, the law required that sellers either buy a more expensive home or pay taxes on the difference. Selling a house to move into a rental often carried hefty tax consequences.

The former law made an exception for individuals older than 55, who could take a one-time, tax-free gain of \$125,000 from the sale of a home. Now all sellers, regardless of age, can enjoy a tax-free windfall if they meet the requirements.

Under the old "over 55" law, Solursh would have had to pay taxes on any profit above \$125,000. Instead, all the profit was tax-free.

She gave some money to her daughter to help her fix up her own home, then handed the rest over to her investment broker, who padded Solursh's retirement cushion by investing the remainder in tax-free bonds.

When her real estate broker, Sheila Dick, of Prudential/John Aaroe of Beverly Hills, told Solursh about her tax-free gains, Solursh said, "I thought, 'Well that was a lucky break,' and I never thought about it again."

While some sellers stumble onto the tax break by accident, others in the know are taking full advantage of it.

Beverly Hills broker Peter Maurice, of Coldwell Banker, who serves a largely affluent clientele, estimates that 75% of his customers are aware of the law. About 25% of his deals are driven by it. "While the tax-free gain may be a significant factor," he said, "it is not the most important factor."

But for Doug Painter of Los Angeles, the break was a key factor in his recent decision to sell. The 45-year-old attorney had owned a home in the Beverly Hills Post Office area since 1995, then sold in February. After closing costs, he netted around \$300,000. Painter, who is single, estimated that on his income taxes he'll pay a capital gains tax on about \$50,000, but \$250,000 of the profit will be tax-free.

Painter put \$160,000 down on a new, smaller home, which he just purchased for \$800,000 in the Spalding Square area. The rest is in the bank.

"I got my equity out of jail and put it to better use," he said. "I certainly wouldn't have done the transaction if it weren't for the law."

A partner in the Glendale-based law firm DeWitt, Denney & Painter, Painter said having more cash in the bank will allow him to travel more and take on long-term contingency cases that he otherwise would have declined.

"Doug was a very astute seller," said Maurice, who handled the transaction. "He put all the important factors together before making his move."

Before sellers consider cashing out, however, they should have a clear idea of what they want to do next, experts advise. They must decide whether they are going to rent, buy down, buy up or move out of state.

Then they need to look down the road at the tax implications of that decision. For example, if they don't buy again, they should consider the impact of losing their mortgage interest deduction.

Sellers also should factor in the size of the gain, interest rates and moving and closing costs, which can take a sizable bite out of any profit.

Finally, they need to consider the cost of obtaining the new mortgage and the property taxes.

"Perhaps the biggest downside of this tax advantage is the nightmare of moving," said Ron Goldhammer, an agent with Prudential in Beverly Hills, who has taken advantage of this benefit twice himself. "It's a great tax break, but moving is incredibly strenuous. You have to ask if it's worth it."

For some homeowners it is. Cashing in on a substantial amount of equity tax-free can offer a great opportunity to diversify and better leverage your assets, Maurice said. It can be particularly ideal for retirees looking to scale down, or for those who want to free up capital for business ventures.

Joseph Ferrante of Arcadia used his tax-free home sale profits to jump-start his business.

The 54-year-old attorney wanted to get back to practicing law after leaving the profession for a couple of years. With the help of his broker, Michael Ferlisi, of Baldwin Real Estate in Arcadia, Ferrante sold his two-bedroom condo -- purchased in 1998 for \$320,000 -- for \$424,000 in February. After closing costs, his tax-free

profits were about \$90,000.

Ferrante is using that gain as seed money to start his new law firm. Meanwhile, he's renting back the condo he sold and said he believes that later this summer he'll be in a position to buy again.

"If I'd had to pay taxes on those gains, or roll them right into more expensive real estate, this just wouldn't have been feasible," Ferrante said.

One way to take advantage of the tax-free gain is to use part of it to put down on a new home, take advantage of the low interest rates to finance the new mortgage and invest the rest in a cash-generating venture.

Jay Belson, 45, owner of ReMax on the Boulevard, a San Fernando Valley real estate brokerage with seven offices and more than 300 agents, did just that.

Six months ago, he and his wife, Tyler Belson, sold their Studio City home for \$1.4 million. They downsized into a new home, took the maximum \$500,000 tax-free gain and bought two apartment buildings. The proceeds from those two apartment buildings now pay their mortgage. The additional income they earn goes toward new investments and travel. "All the pieces were right in front of me," Belson said. "Play it right, and this is one of the best ways to not just gain financial security but financial freedom."

Despite the substantial upside for many people who have built up equity in their homes, experts in the field don't see a huge number of homeowners selling just to take advantage of the tax break.

"Most people still move because their job changes and they have to, or because they want that bigger house," said tax accountant Yegsigian. "Selling just to realize the tax-free gains is, apparently, just not a big enough incentive."

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Boost from lower capital gains tax

Homeowners clearing more than \$250,000 if single, or \$500,000 if married, in net profits from sales of their primary residences may now keep more of the taxable portion of their gains. Last month, President Bush signed the tax-relief act into law, which reduces the amount to be paid on such long-term capital gains.

For example, a single owner clearing \$350,000 in profits on a home sale would be subject to capital gains tax on \$100,000. Under the old law, taxes would be \$20,000 or 20% of that gain for sellers in the top tax bracket and \$10,000 or 10% in the lower two tax brackets.

Under Bush's new plan, the tax ranges from 15% to 5%, depending on the bracket. But there's a catch: Homes must have sold after May 6, 2003, to qualify for the lower capital gains tax.

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The rules governing the tax benefit after a divorce or a spouse's death

Can an individual still receive the maximum \$500,000 tax benefit if a spouse dies or the couple divorces?

The Internal Revenue Code states that a surviving spouse can claim the full \$500,000 benefit if he or she sells the home in the tax year of the spouse's death. If the surviving spouse sells after that, he or she can only claim up to the \$250,000 benefit. However, depending on how title is held, the surviving spouse can often receive a "stepped-up basis" on the property, meaning that the home's new basis becomes equal to the market value as of the date of the spouse's death rather than the original purchase price. That could substantially reduce the amount of money subject to capital gains tax after the sale.

Couples who are divorced or separated can also share the \$500,000 tax benefit, provided at least one lived in the house for two of the last five years before the home's sale.

Other variables apply, so consult a tax advisor.

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Crunching the numbers

This example shows how to determine net home-sale profits for a home seller who is single. See a tax advisor for exceptions and specifics. Remember, the down payment and what is owed on the house are not part of the equation:

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|-------------------------------------|-----------|
| Original purchase price | \$250,000 |
| + costs to acquire | \$3,000 |
| + capital improvements* | \$50,000 |
| = total cost basis | \$303,000 |
| Selling price | \$500,000 |
| -- closing costs | \$25,000 |
| -- costs to fix up house for sale** | \$10,000 |
| = net realized | \$465,000 |
| Net realized less total costs | |
| = net profit | \$162,000 |

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* Renovations such as patios and other "hardscaping," room additions, custom built-ins and structural improvements.

** Costs to fix up a home for sale include such items as paint, new carpeting and household repairs performed within 90 days of the sale and done primarily for the purpose of reselling the property.

Source: Mission Tax & Financial, Laguna Hills

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