When capital gains tax applies to primary residence

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I bought a condominium in February 2012 as my primary residence for $229,000 and sold it in October 2013 for $385,000. We bought a new home for residential use and invested the gains into that one. Is there any way around the capital gains tax to soften the blow? I stopped working in August 2013. The condo was in my name, then I got married and we bought the new home as a married couple.

When it comes to principal residences, the IRS gives homeowners a huge break when they sell their homes for a profit. If you've lived in your home for two out of the last five years and sell, you can exclude from capital gains taxes $250,000 in profits from the sale. If you're married, you are entitled to exclude $500,000 in profits.

In your case, you're selling after having owned the home for about a year and a half. In some cases, the IRS would allow you to exclude a proportionate share of your income.

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Home sellers may owe taxes.

The good news is that capital gains rates are lower than ordinary income tax rates.

According to Chet Burgess, an enrolled agent based in Atlanta, the proportionate exclusion is available if the sale after less than 24 months of ownership results from either a change in the place of employment (your new job must be at least 50 miles from your old job), certain health issues, or what the IRS calls "unforeseen circumstances," which might include having twins or triplets instead of a single birth, getting divorced or the death of a spouse — all of which require a move.

Members of the uniformed services and the Foreign Service, employees of intelligence agencies, and employees or volunteers of the Peace Corps are also granted an exception to the two-year rule. Finally, if you and your spouse file a joint return for the year of sale and one spouse meets the ownership and use test but the other doesn't, you should be able to exclude up to $250,000 of gain.

The difference between your purchase price and your sales price is $156,000. That number is not all profit and you will need to compute the amount of your profit after you consider costs of purchasing and selling the home. If you made capital improvements to the condominium (such as reconstructing a bathroom rather than replacing the carpet), you should be entitled to include those improvements into the basis of the home and reduce the amount of tax you will owe. Most likely, whatever amount of profit you come up with will be significant.

Years ago, the IRS charged no tax to homeowners if they sold a primary residence and rolled over the proceeds from the sale into a new home. But that rule is long gone. Based on the information you have included in your question, you will have a sizable gain on the sale of the home and will need to pay taxes on that sale. The good news is that capital gains rates are lower than ordinary income tax rates, but you'll probably have to pay a good chunk of money to the IRS.

Depending on your income bracket, the maximum capital gains tax rate was 20 percent in 2013. However, in addition to that tax, you may be subject to the Medicare surtax on net investment income of 3.8 percent. When you have a large amount of capital gains, those gains can affect your income tax return in other ways. Since you married last year, you'll have to decide whether you are better off filing jointly or individually.

Please consult with your tax adviser for more information and be sure to check out IRS Publication 523, Selling Your Home, which is available online at IRS.gov.

Ilyce R. Glink's latest book is "Buy, Close, Move In!" **Samuel J. Tamkin** is a Chicago-based real estate lawyer. If you have questions, you can call Glink's radio show (800-972-8255) any Sunday from 11 a.m. to 1 p.m. Contact Glink and Tamkin through the Web site *www.thinkglink.com*.