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REAL ESTATE PROFESSIONALS
248.733.5812

HOW CAPITAL GAINS TAXES WORK

Understanding your profits, exemptions, and smart strategies before you sell



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WHAT ARE CAPITAL GAINS TAXES?



When you sell your home for more than you paid for it, the profit you earn is called a capital gain. The IRS may tax that gain—but not every seller owes money.

Capital gains taxes apply to the difference between your purchase price (plus certain improvements) and your sale price. The good news? Most homeowners qualify for generous exclusions that can wipe out a large portion—or even all—of the taxable gain.

This guide explains how it all works, who qualifies for exemptions, and what smart planning steps can help you keep more of your hard-earned equity.

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PRIMARY RESIDENCE EXCLUSION: THE BIG TAX BREAK

If the home you're selling is your primary residence, you may be eligible for a major tax exemption.

Here's the rule:

- Individuals can exclude up to $250,000 in profits.
- Married couples filing jointly can exclude up to $500,000.

To qualify, you must:

- Have owned the home for at least two years
- Have lived in it for at least two of the last five years
- Not have claimed this exclusion on another home sale in the past two years
- Example:
  - If you bought your home for $300,000 and sell for $600,000, a married couple can exclude that $300,000 gain entirely from taxes.

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WHEN THE EXEMPTION DOESN'T APPLY

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There are certain situations where the primary residence exclusion might not apply—or only partially applies:

- The property was a rental, second home, or investment
- You haven't met the 2-year ownership or use test
- You claimed the exemption within the last two years
- In those cases, you may owe capital gains tax on part (or all) of your profit.
- Pro Tip: Even if you don't fully qualify, you might be eligible for a partial exclusion if the sale was due to specific reasons—like job relocation, health, or other unforeseen circumstances.

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CALCULATING YOUR CAPITAL GAIN



Here’s the basic formula:
Selling Price – (Purchase Price + Home Improvements + Selling Costs) = Capital Gain

Let’s break it down:

- Purchase Price: What you originally paid for the home.
- Home Improvements: Permanent upgrades like a new roof, addition, kitchen remodel, or HVAC replacement (not routine maintenance).
- Selling Costs: Real estate commissions, title fees, and closing costs.
- These adjustments raise your “cost basis,” reducing your taxable gain.
- **Example:**
  - Bought for $300,000 → Added $40,000 in improvements → Sold for $500,000 →
  - Your taxable gain is only $160,000—not $200,000.

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INVESTMENT & RENTAL PROPERTIES

Selling an investment or rental property is different. These sales don't qualify for the primary residence exclusion. Instead, **gains are taxed based on how long you owned the property:**

- **Short-term capital gains (under 1 year):** Taxed as ordinary income
- **Long-term capital gains (1 year+):** Taxed at 0%, 15%, or 20% depending on income
- However, savvy investors can defer paying taxes entirely using a 1031 Exchange, which allows you to roll profits into another "like-kind" property without immediate tax consequences.
- Always consult with a CPA or tax advisor before selling an investment property to ensure compliance.

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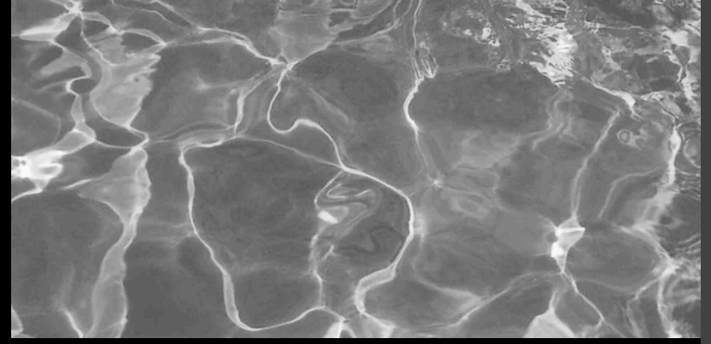
HOW TO REDUCE OR DEFER TAXES LEGALLY

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Even if you owe capital gains tax, there are smart ways to minimize your bill:

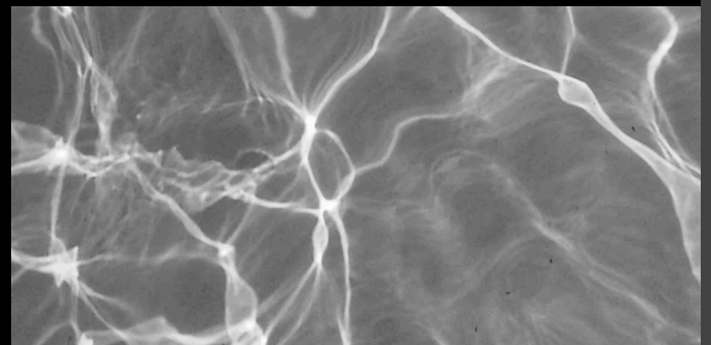
- Track all home improvements: Every dollar you spend improving the property increases your cost basis.
- Time your sale: Selling in a lower-income year could reduce your tax rate.
- Consider a 1031 Exchange for investment properties.
- Consult early with a tax professional: They can help you project gains, estimate liabilities, and identify deductions.
- Proactive planning before listing gives you the most flexibility.

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SPECIAL CIRCUMSTANCES & EXCEPTIONS

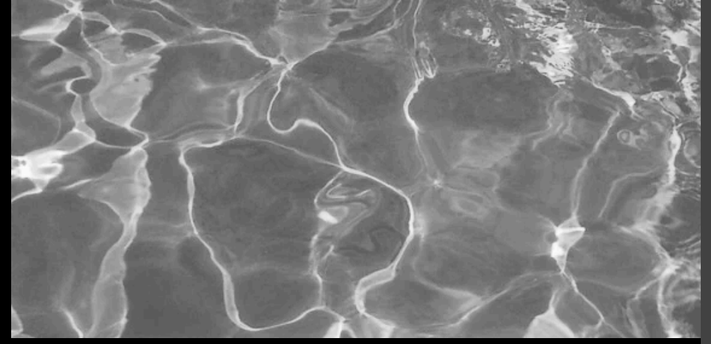


You may still qualify for reduced tax liability if:

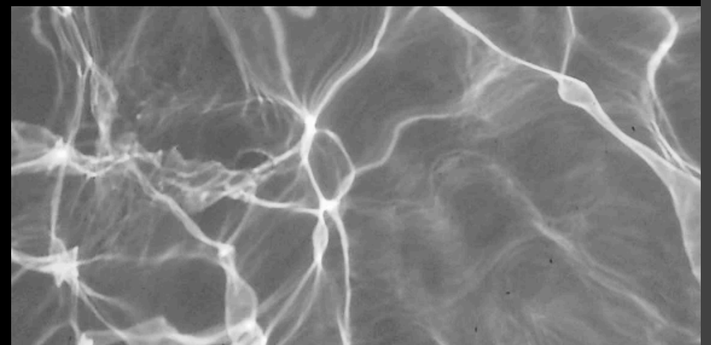
- You sold due to relocation, job change, or health reasons
- The property was inherited or gifted (different tax basis rules apply)
- You experienced a divorce, military deployment, or other life change recognized by the IRS
- Understanding your unique circumstances helps ensure you don’t leave money on the table—or pay taxes unnecessarily.

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PREPARING FOR A TAX-SAVVY SALE



Here’s your quick action plan before listing:

Gather records of your purchase price, closing costs, and improvements.

Review how long you’ve owned and lived in the home.

Talk with your real estate agent about your expected sale price and net proceeds.

Meet with a tax advisor early to plan your best strategy for exemptions and deductions.

Taking these steps before your home hits the market makes tax season smoother—and maximizes what you keep.

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FINAL THOUGHTS

Selling your home can be one of the biggest financial moments of your life—and understanding capital gains taxes is key to keeping that success intact. With the right preparation, most homeowners can sell tax-free or with minimal liability.

If you're planning a sale this year and want a personalized look at your potential gains, exclusions, and best next steps, reach out today. We'll help you make your move strategically—so your profits stay where they belong: with you.



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