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Understanding Capital Gains in Real Estate

When you sell a stock, you owe taxes on your gain — the difference between what you paid for the stock and what you sold it for. The same holds true when selling a home (or a second home), but there are some special considerations.

How to Calculate Gain

In real estate, capital gains are based not on what you paid for the home, but on its adjusted cost basis. To calculate, follow these steps:

1. Purchase price: _______________

The purchase price of the home is the sale price, not the amount of money you actually contributed at closing.

2. Total adjustments: _______________

To calculate this, add the following:

- Cost of the purchase — including transfer fees, attorney fees, and inspections, but not points you paid on your mortgage.
- Cost of sale — including inspections, attorney fees, real estate commission, and money you spent to fix up your home just prior to sale.
- Cost of improvements — including room additions, deck, etc. Note here that improvements do not include repairing or replacing something already there, such as putting on a new roof or buying a new furnace.

3. Your home's adjusted cost basis: _______________

The total of your purchase price and adjustments is the adjusted cost basis of your home.

4. Your capital gain: _______________

Subtract the adjusted cost basis from the amount your home sells for to get your capital gain.

A Special Real Estate Exemption for Capital Gains

Since 1997, up to $250,000 in capital gains ($500,000 for a married couple) on the sale of a home is exempt from taxation if you meet the following criteria:

- You have lived in the home as your principal residence for two out of the last five years.
- You have not sold or exchanged another home during the two years preceding the sale.
- You meet what the IRS calls "unforeseen circumstances," such as job loss, divorce, or family medical emergency.