

## **Excluding Gain from a Residence Following Divorce**

A taxpayer can generally exclude from taxable income up to \$250,000 (\$500,000 for qualifying joint filers) of gain from the sale of a home owned and used as a principal residence for at least two of the five years before the sale (the ownership and use tests). The exclusion is further limited to taxpayers who have not previously claimed the exclusion for a minimum of two years ending on the date of the current sale or exchange (the one-sale-every-two-year rule).

A residence with substantial equity is often a married couple's most significant asset. As a result, monetary and tax considerations for property settlements related to the marital residence are usually very important to divorcing taxpayers. Residence sold as part of divorce proceedings. The divorce agreement may specify that the residence must be sold as part of the divorce process so that the proceeds can be split between the spouses. If the property is owned jointly or is community property, each spouse is considered to have sold half the property. If each spouse independently meets the two-out-of-five-years ownership and use tests, and the one-sale-every-two-year rule, then each spouse's share of the gain can be sheltered by the up-to-\$250,000 exclusion. The fact that the spouses file separate returns for the year of sale, or are divorced and file as single persons, does not make a difference. Ownership transferred incident to divorce. Neither spouse recognizes gain or loss with the transfer of ownership of the principal residence from one spouse to the other during marriage or in divorce. The receiving spouse's basis in the residence is the combined basis of both spouses before the transfer. Even in those circumstances where the transferring spouse receives other assets or cash to even out the property settlement, there is no gain or loss or change in the basis of the residence.

If a taxpayer transfers a residence to a spouse or former spouse incident to a divorce, the transferee's ownership period includes the transferor's ownership period. This rule helps the transferee meet the ownership test, but not the use test. That is, the transferee will not pass the use test unless he or she occupies the residence for at least two out of five years ending on the date of sale.