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Tax on Sale of Residence

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You may have received an email telling you that if you sell your house after 2012, you will pay a 3.8% sales tax. This message has gone viral and has reached millions of taxpayers. While it may be true for some, the tax will only affect a small number of taxpayers.

The 3.8% tax in the message applies to the additional Medicare tax that begins in 2013. The current Medicare tax is 2.9% and only applies to earned income. This is the income from wages and self-employment. While the employer pays one-half of the tax for employees, the self-employed person pays the entire tax. The increase in the Medicare tax is a part of the Health Care Act and is designed to provide additional funding to pay for the legislation.

A 0.9% additional Medicare tax will be imposed on the lesser of net investment income or modified adjusted gross income (MAGI) on single taxpayers with an MAGI in excess of $200,000 and joint filers with MAGI in excess of $250,000. This means only the so called “high income” taxpayers will begin paying the additional Medicare tax.

However, the sale of a principal residence is covered under Section 121 of the Internal Revenue Code. IRC §121 exempts the sale of a principal residence if certain qualifications are met.

1. The taxpayer must have lived in the home for 2 of the previous 5 years. (There are other provisions for military personnel.)
2. The first $250,000 of gain for a single taxpayer and $500,000 for a joint filer is excluded from taxable income if the first qualification is met.

Therefore, unless the taxpayer has a very large gain on the sale of the home, it will not be included in their MAGI even if they are a “high income” taxpayer.

1 *farmdoc daily* August 17, 2011