Tax Break for Sales of Inherited Homes

Article Highlights:

- Inherited Basis
- Certified Appraisals
- Loss On Sale
- Potential Law Change

People who inherit property are often concerned about the taxes they will owe on any gain from that property's sale. After all, the property may have been purchased years ago at a low cost by a deceased relative but may now have vastly appreciated in value. The usual question is: "Won't the taxes at sale be horrendous?"

Clients are usually pleasantly surprised by the answer—that special rules apply to figuring the tax on the sale of any inherited property. Instead of having to start with the decedent's original purchase price to determine gain or loss, the law allows taxpayers to use the value at the date of the decedent's death as a starting point (sometimes an alternate date is chosen). This often means that the selling price and the inherited basis of the property are practically identical, and there is little, if any, gain to report. In fact, the computation frequently results in a loss, particularly when it comes to real property on which large selling expenses (realtor commissions, etc.) must be paid.

This also highlights the importance of having a certified appraisal of the home to establish the home's tax basis. If an estate tax return or probate is required, a certified appraisal will be completed as part of those processes. If not, one must be obtained to establish the basis. It is generally not acceptable just to refer to a real estate agent's estimation of value or comparable sale prices if the IRS questions the date of death value. The few hundred dollars it may cost for a certified appraisal will be worth it if the IRS asks for proof of the basis.

Another issue is whether a loss on an inherited home is deductible. Normally, losses on the sale of personal use property such as one's home are not deductible. However, unless the beneficiary is living in the home, the home becomes investment property in the hands of the beneficiary, and a loss is deductible but subject to a $3,000 ($1,500 if married and filing separately) per year limitation for all capital losses with any unused losses carried forward to a future year.

In some cases, courts have allowed deductions for losses on an inherited home if the beneficiary also lives in the home. In order to deduct such a loss, a beneficiary must try to sell or rent the property immediately following the decedent's death. In one case, where a beneficiary was also living in the house with the decedent at the time of death, loss on a sale was still deductible, when the heir moved out of the home within a "reasonable time" and immediately attempted to sell or rent it.

This treatment could change in the future, however. The President's Fiscal Year 2016 Budget Proposal includes a proposal that would eliminate any step up in basis at the time of death and would require payment of capital gains tax on the increase in the value of the home at the time it is inherited.

If you have questions related to inheritances or home sales, please give this office a call.