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Sale of residence exclusion expanded

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The newly enacted Mortgage Forgiveness Debt Relief Act of 2007, contains a provision that benefits surviving single spouses. Under prior law, a surviving single spouse who sold the family residence was allowed a $250,000 exclusion on the gain from the sale. This gain was calculated by subtracting the adjusted basis in the property from the sale proceeds. The basis would be the sum of one half the original cost of the home (increased by improvements made to date of sale), plus one half of the decedent's stepped up date of death value of the residence.

The calculation of the surviving spouse's basis, including the basis step-up, remains the same. However, the new provision allows a $500,000 exclusion to the single surviving spouse on the sale of the residence. This provision applies to single surviving spouses who sell their homes within two years from the date of death of the spouse. As such, it is possible that a surviving spouse could sell the home two tax years after the spouse died, but more than two years from the date of death, thus making the exclusion only $250,000. For example, if a spouse died March 31, 2008 but the house was sold June 30, 2010 it would be ineligible for the increased $500,000 exclusion.

The effective date of this change is for sales occurring after December 31, 2007. The new provision requires that the taxpayer would have otherwise met all the requirements for the previous $250,000 exclusion. These include either spouse owning the home for 2 out of the previous 5 years, both spouses using the home as a residence for 2 out of the previous 5 years and neither spouse has used the exclusion in the prior 2 years.

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