



When the sale of an appreciated home triggers taxes — and when it doesn't

Home values have risen significantly in many areas of the country over the last several years, leaving some homeowners with substantial gains when they sell. Of course a large profit is generally a good thing. But, depending on the amount of your gain, how long you've owned and resided in the home, and your income level, a sale may trigger capital gains tax and, in some cases, the net investment income tax (NIIT).

Save tax with the gain exclusion

If you're selling your *principal* residence and meet certain requirements, you can exclude from tax up to \$250,000 of gain (\$500,000 for married couples filing jointly).

To qualify for the exclusion, you must:

1. Have owned the property for at least two years during the five-year period ending on the sale date.
2. Have used the property as a principal residence for at least two years during the five-year period. (Periods of ownership and use don't need to overlap.)

In addition, you can't use the exclusion more than once every two years.

Be aware of ineligible gain

What if you have more profit than your gain exclusion? Any gain in excess of the exclusion generally will be taxed at your long-term capital gains rate (typically 15% or 20%), as long as you owned the home for more than one year. If you didn't, the gain will be considered short-term and subject to your marginal ordinary-income rate (usually 22% to 37%).

If you're selling a *second* home (such as a vacation home), it isn't eligible for the gain exclusion and the entire gain generally will be subject to capital gains tax. But if the home qualifies as a rental property, it can be considered a business asset. In that case, you may be able to defer tax through an installment sale or a Section 1031 like-kind exchange.

Watch out for the NIIT

When does the NIIT apply to a home sale? If you sell your principal residence and qualify for the gain exclusion, the excluded gain isn't subject to the 3.8% NIIT.

However, gain that exceeds the exclusion is subject to the NIIT if your modified adjusted gross income (MAGI) is over a certain amount. Gain from the sale of a vacation home or other second residence, which doesn't qualify for the exclusion, may also be subject to the NIIT.

The NIIT applies only if your MAGI exceeds \$200,000 (\$250,000 for joint filers or \$125,000 for married taxpayers filing separately). If your MAGI is above the applicable threshold, additional factors will affect your NIIT liability. Be aware that the NIIT kicks in *before* the top long-term and ordinary-income rates apply.

Keep track of your basis

Gain on your home is calculated by subtracting your tax basis in the home from the sale price. Your basis generally includes what you paid for the home plus major improvements you made to it.

To support an accurate basis, be sure to maintain complete records, including information about your original cost and subsequent improvements (such as a kitchen remodel or a new roof). But basis-increasing improvements *don't* include maintenance and repairs (such as painting your kitchen or fixing a leak in your roof). Also, you must *reduce* your basis by any casualty losses or depreciation claimed for business use (such as if a portion of your home was rented out or you claimed the home office deduction).

If your basis is *more than* what you sell your home for, your loss generally won't be deductible. But if a portion of your home was rented out or used exclusively for business, the loss attributable to that part may be deductible.

Plan for the tax impact

A home sale can be tax-free or create a sizable tax liability — or result in a tax bill between those extremes. If you're thinking about selling your home, it's important to know the potential tax impact. Contact us before putting your home on the market so we can help you estimate the tax impact and discuss possible planning opportunities.

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