



# SALE OF MARITAL RESIDENCE IN A DIVORCE CONTEXT – TAXATION OF GAIN

BY JOSEPH W. CUNNINGHAM, JD, CPA

As is generally known, prices of homes in Michigan have increased substantially in the last couple years. Sellers are frequently receiving multiple offers above their asking price.

So, most homes sold in these conditions will result in considerable gains over what the seller paid for the house.

Because of the recent surge in home sale prices, the following summarizes how the gains on residential sales are treated for tax purposes in a divorce context.

## General Rules of Taxation on Principal Residence Sale

There is an exclusion for tax purposes of gain on the sale of a principal residence - up to \$250,000 for qualifying single taxpayers and \$500,000 for qualifying married taxpayers who file a joint tax return.

To qualify for the exclusion, a single taxpayer must own and live in the home as a principal residence for two of the five years preceding the sale.

A taxpayer who fails to satisfy the use requirement due to a change of employment, health problems, or other unforeseen circumstances is allowed a percentage of the exclusion equal to the percentage that the two years ownership and use requirements are met.

For a married couple, one spouse must satisfy the two out of five years ownership requirement, but **both** must have lived there for two of the five years preceding the sale.

A taxpayer may use the exclusion each time a home is sold, provided two years have elapsed since the last sale.

As a practical matter, even with the recent increase in home prices, the lion's share of gains will not exceed the exclusion. However, particularly for houses held for many years in upscale areas, gains might be higher than the exclusion.

## Sale In A Divorce Context

### Home Sold While Married

The marital status on the date of sale determines whether the parties are married for purposes of the exclusion.

If parties are married on the date of sale, the \$500,000 gain exclusion is available provided:

- The parties file a joint return for the year of sale. This means that the divorce does not occur in the year of the sale.
- One of the spouses satisfies the two out of five years ownership requirement
- **Both** satisfy the two out of five years use requirement.
- Neither has used the exclusion within two years preceding the sale.

### Special Rules Applicable to Divorce-Related Sales

- **Attribution of Ownership** - When an interest (e.g., fifty percent) in the marital residence is transferred from one spouse to the other pursuant to the divorce, the transferor's period of ownership passes with the property to the transferee.

Example:

- H and W agree that she will transfer her 50% interest in their home to him.
- H decides to sell the house 2.5 years after the divorce.
- W's period of ownership is transferred to H with respect to the 50% interest she transferred to him.

- Thus, he satisfies the two out of five years ownership requirement and, hence, qualifies for the \$250,000 exclusion on the entire gain, not just the 50%.
- **Attribution of Use** - If it is *expressly* provided in the divorce settlement that one spouse is entitled to remain in the home until it is sold (often when the youngest child is emancipated), that spouse's use is attributed to the other (who is usually out of the house and would not otherwise qualify).

**Example:** In their settlement, H and W agree that:

- They will continue to jointly own the house;
- W will live there with their child; and,
- The home will be sold and proceeds divided in four years when their child graduates from high school.

Provided that the divorce settlement *expressly* provides for W's right to remain in the home until it is sold, then her occupancy is attributed to H for purposes of the two years use requirement. Thus, the \$500,000 exclusion is available.

### About the Author

*Joe Cunningham has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy, though his practice is statewide.*

**Email:** [JoeCunninghamPC@gmail.com](mailto:JoeCunninghamPC@gmail.com)

**Website:** <https://JoeCunninghamPC.com>