Real Estate Sales Tax and the Health Reform Bill

There has been a lot of talk recently about how the health-care legislation that was recently passed, introduced a sales tax on real estate. While there is a new sales tax for real estate, the facts are that it will not impact everyone; in fact the chances are it will not impact you at all.

Here are the facts, in the bill there is a provision for a tax of 3.8% on profits from the sale of residential or investment real estate, which is due to come into effect on the 1st of Jan 2013. But this tax is aimed at high earners, and will not touch the vast amount of people. For a start if your adjusted gross income is less than $200,000, you do not need to worry. This limit is $250,000 for married couples who file jointly and $125,000 each if you file separate returns.

In addition to this, the current tax breaks when you sell your home have not been changed. This means that a married couple can take a tax free gain of up to $500,000 when they sell their home, assuming that they qualify given the current rules (lived in the property for 2 out of the last 5 years etc.).

Let’s look at a few examples. A married couple has an adjusted gross income of $240,000, sell their home for a $490,000 gain. How much Health Reform Property Tax will they pay? The answer is none. They can offset the $490,000 against the current tax free allowance of $500,000 and so don’t have to pay the new 3.8% tax.

Let’s stick with the above example but say that the couple now earns $330,000. Even though they now earn more than the $250,000 allowed under the new rules, they still don’t have to pay any additional tax, because the $490,000 gain is below the current tax free allowance of $500,000.

Sticking with the above example lets change it so that they make a profit on the sale of their home of $600,000. Now this is where it starts to get complicated. The $600,000 is above the allowed limit of $500,000, so they would have to pay capital gains tax on amount over $500,000. Therefore they would pay the current capital gains tax rate on $100,000 (remember none of this is new, these are just the current rules).

In addition to this, since the couples income is over the new Health Reform Bill tax threshold, they now have to pay the 3.8 percent tax. But on what amount? The tax is payable on the lesser of the taxable profit made from the sale of their home ($100,000) or the difference between their income and the $250,000 threshold ($80,000). Therefore they will have to pay the 3.8% tax on the $80,000, which is $3,040.

So you see from the above examples, apart from being complicated, there is probably not that much to worry about, and the chances of you having to pay any additional amount to the tax man are remote. Having said that you should always consider consulting with your tax and financial advisers regarding your exposure to the new rules.