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HOUSING COUNSEL

Siblings share Mom's house and tax issue

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Editor's note: Benny L. Kass is a practicing attorney in Washington, D.C. and in Maryland and is senior partner of Kass, Mitek & Kass, PLLC. He answers real estate questions of general interest in this column.

Question: My mother passed away in June, leaving her home in equal shares to me and my two siblings. My brother is the executor of the estate and has petitioned the court to open probate. She owned the home in Northern California free and clear.

We have concerns about inheriting and possibly selling the house. I have heard that as children of the deceased owner, we qualify to own this house and pay taxes for it based on the price that my mother paid for it, rather than its current value. This would be a difference of about \$300,000.

If we are able to keep the tax basis the same, and we decide to sell the house after some time without ever living in it, will we be subject to a capital-gains tax on the difference between its selling price and the price my mother paid?

Must we sell the house through the probate process to avoid getting taxed on a portion of the sale?

What other considerations come into play when inheriting a house and co-owning (or selling it) with trusted and true siblings?

Answer: Because I do not practice law in your state, I will respond only to the federal income implications. Your brother has retained counsel to institute probate (or at least he should have an attorney), and that lawyer should be able to answer many of your questions.

Let me give you this example: Your mother and father bought the house years ago for \$50,000. Their respective basis for tax purposes was \$25,000 each. Your father died 10 years ago when the house was worth \$100,000.

In tax law, there is a concept called the "stepped up" basis, which means that upon the death of one owner, the tax basis for the heirs is determined on the date of death (this is oversimplified for my example). So, half of the value of the house was transferred to your mother, so now her basis is \$75,000 (her original \$25,000 plus the \$50,000).

Now, at her death, the property is appraised at \$400,000. The three of you will inherit the house and your tax basis will be \$400,000. If you sell it for that price, you will not have to pay any capital-gains tax. If you sell it for more than \$400,000, the capital-gains tax will be based only on that difference.

Of course, if one or all of you decide to move into the property and live there for two years out of the five years before it is sold, you can take advantage of the up-to-\$250,000 exclusion of gain (or up to \$500,000 if you are married and file a joint tax return).

Ask your lawyer about the probate process.

Depreciation and income tax

Q: In 2007, we sold our home where for 10 years we ran a home-based computer business and claimed home-office expenses. I understand that we must report depreciation taken for that period on our 2007 income tax return.

Is the total depreciation taken over 10 years taxable? Is it ordinary income or capital gains?

We also sold the trade name and client list for \$20,000 -- no property or assets. I have downloaded numerous publications and instructions from the IRS and cannot find definitive information on tax treatment for this situation.

A: I hope you were taking depreciation for all of the years you claimed your home-office expenses. In tax law, there is a concept called "recapture," which means that when you sell the investment property (or in your case a portion of the property, which was the home office) you have to pay income tax on the amount of the depreciation.

However, tax law is a highly specialized area, and my best advice is for you to retain a certified public accountant who can assist you in filing your 2007 income tax return. The CPA will tell you that the portion of the house that was your principal residence will probably be eligible for the up to \$250,000 exclusion of gain (the exclusion is up to \$500,000 if you are married and file a joint return).

But the tax treatment of the home office will be different.