

Fickewirth Tax Newsletter

Jennifer Lincicum, Editor

April 2013

60 S. California St., 4th Floor - Ventura, CA 93001-2802
(805) 653-2030 Fax: (805) 653-2035
www.Fickewirth.com - E-mail: jlincicum@fickewirth.com

April 2013

Dear Reader:

According to the National Association of Realtors (NAR), the inventory of homes for sale has reached its lowest level since 1999, which is helping home prices rise in many markets. After a 9 percent increase in existing home sales last year, there are simply fewer houses available. This has created a seller's market in much of the country.

Buyer traffic is up 40 percent from this time last year, so while demand has increased exponentially. Insufficient inventory is what's lagging sales. Laurence Yun, chief economist for the NAR, has noted that the current supply and demand ratio is apt to result in more frequent incidences of multiple bidding and faster-than-normal price growth¹. Yet despite recent price gains, mortgage interest rates continue at record lows.

All of these signs point to an invigorated residential real estate market this spring. Homeowners who have been waiting for values to rise may be more willing to sell their homes in order to relocate for better job prospects, which could help the unemployment situation. Others who have been waiting to trade up or down, depending on their age and financial situation, appear ready to participate in a robust market this year.

Buying and selling isn't the only activity where real estate finances are concerned. Pre-retirees who want to "age in place" are taking advantage of what may be the tail end of low interest-rate refinancing to remodel their homes with more senior-friendly enhancements.

One issue homeowners are dealing with is whether they can get back the money they invest in upgrades. Another consideration is how to take advantage of any tax breaks for home sellers, buyers, and refinancers, in light of the changes and quagmire of legislative and agency provisions of late.

To that end, this month we provide a review of the tax laws and public agency guidelines issued recently as they relate to today's real estate market.

Cordially,



Jennifer Lincicum

¹ National Association of Realtors, March 2013.

New Taxes, Guidelines and Legislation Pertaining to Real Estate

American Taxpayer Relief Act of 2012

The recent tax bill ratified by Congress included several provisions that will impact homeowners, sellers and buyers in the coming year. For example, the deduction for private mortgage insurance has been reinstated and is retroactive for premiums paid in 2012 through the end of 2013. A full deduction is available to single and married-filing-jointly homeowners with AGI of \$100,000 or less, while married couples who file separately may write off 50 percent of premiums. Homeowners with taxable income between \$100,000 and \$110,000 may qualify for a partial deduction on a sliding scale (10 percent reduction for each \$1,000 over \$100,000).

The new tax bill also extends debt forgiveness to homeowners who undergo a short sale or foreclosure by the end of 2013. These sellers are not required to pay taxes on the amount of debt forgiven in the sale.

For most home sellers, the first \$250,000 (\$500,000 for married couples) in profit you make on a home sale is exempt from capital gains. To claim the exemption, you must have owned and lived in the home as your principal residence an aggregate of at least two of the five years before the sale (this is called the ownership and use test). Note that if you spend time in a nursing home, it still counts toward ownership time and continued use of your home. However, the ownership and use test is reduced to living one out of five years in your home before entering the facility.

Anything over the home seller profit thresholds are subject to capital gains taxes on the excess amount. For many that tax rate remains at 15 percent, but if your taxable income exceeds \$400,000 (\$450,000 for married filers), the excess will be subject to the new, higher capital gains rate of 20 percent starting this year.

Note that capital gains on a home sale can be reduced by certain expenses. You can calculate the taxable amount by subtracting from your sales price the following:

- The price you originally paid for your home
- The cost of any capital improvements you made (minus depreciation)
- Selling costs (brokers' commissions, title insurance, legal fees, advertising, etc.)
- Deductible closing costs (points, prorated property taxes, etc.)

Be aware, too, that any expenses you incurred to spruce up and stage your home for sale also may qualify as selling costs as long as you complete them with the intention of making the home more saleable and within 90 days of the sale. These items may include painting, wallpapering, carpeting, refinishing floors, replacing windows, landscaping, maintenance and repairs.

Even if your home-sale profit qualifies for the lower capital gains rate based on your taxable income, you could still be subject to a 3.8 percent surplus tax that went into effect on January 1 of this year. This additional capital gains tax, enacted as part of the Patient Protection and Affordability Act of 2010, applies to home sellers who earn more than \$200,000 (\$250,000 for couples filing jointly).

One more thing to remember when determining your taxable gains from a home sale: If you have deducted depreciation on a home office over the years, you must subtract those deductions from your cost basis when you sell.

The new tax legislation also reinstated what is known as the “Pease” limitation, which places an 80 percent cap on the itemized deductions you can claim. This means that certain itemized deductions are reduced by three percent of the amount by which your taxable income exceeds \$250,000+ (single) and \$300,000+ (couples filing jointly).

While the new legislation did not eliminate any of the current tax advantages to owning a home, Congress is still debating government spending cuts and/or increasing tax revenue in order to reduce the nation’s deficit. For the moment, you may still deduct the interest you pay on home mortgages and many home equity loans, as well as property taxes.

Consumer Financial Protection Bureau Guidelines

In January, federal regulators at the Consumer Financial Protection Bureau (CFPB) published, for the first time, a set of guidelines designed to ensure that homebuyers can afford to repay the mortgages for which they qualify. Another way to look at the new rules is that they protect new homeowners from predatory lending practices from the pre-recession era. The guidelines are scheduled to go into effect on January 10, 2014.

The new rules ban previously popular no-doc and interest-only loans, and require lenders to verify and inspect borrowers’ financial records to ensure that they have the ability to repay the amount loaned. Specifically, the guidelines state that borrowers should not have total debt payments, including the borrowers’ mortgage, credit cards, car, and student loans, of more than 43 percent of the borrowers’ annual income. The new guidelines also discourage low-interest teaser rates that increase over time, as well as balloon payments required at the end of a loan term. The rules stop short of mandating a specific percentage of down payment so as not to deny credit to otherwise qualified borrowers. The final rule also implements provisions that generally prohibit prepayment penalties except for certain fixed-rate, qualified mortgages.

These mortgage lending guidelines emerged as part of the Dodd-Frank Act. The CFPB is charged with writing and enforcing rules that flesh out the law passed by Congress in 2010. Note that amendments were also set forth to exempt from the rules some loans made by community banks, credit unions, and nonprofit lenders that work with low- and moderate-income consumers.

Real Estate Investor

If you’ve considered buying properties for rental income and/or as a vacation home, it’s important to consider the current tax rules to ensure you understand the ramifications of how much you use the home for your own enjoyment. If you don’t rent a second home out for more than 14 days a year, you may deduct its mortgage interest and real estate taxes on Schedule A, Form 1040.

If your second home is rented for income and you use it less than two weeks a year, or 10 percent of total rental days, whichever is greater, these expenses can be deducted on Schedule E, Form 1040. If you enjoy a vacation home for more than 14 days and rent it out for more than 14 days a year, you must keep written records of your rental income and expenses and divide them proportionately between the time you used the home and the time it was rented. These expenses need to be reported on the two separate Schedules of your tax return.

Potential real estate investors sit at an interesting window of opportunity. During this unique time in history, you may be able to purchase a portfolio of single-family-home rental properties while interest rates and market values are still low, and homeowner tax breaks are still available.

Depending on the outcome of tax debates in Congress this year, such an opportunity may not be available again for some time to come. Be sure to speak with your tax advisor for specific information regarding your own homeowner, home seller, and/or real estate investment situation.

Recent Cases and Rulings

Latson v. Plaza Home Mortgage, Inc.

No. 12-1462; February 2013

Two residents of Massachusetts purchased a three-dwelling residence in Massachusetts, financing the entire purchase price with two mortgage loans from Plaza Home Mortgage (Plaza). After the collapse of the housing market, the homeowners sued Plaza, alleging state common law and statutory violations in making the loans. The district court dismissed the case for failure to state a claim. The First Circuit Court of Appeals affirmed, stating that (1) the good faith and fair dealing claim was properly dismissed because the allegedly wrongful conduct all occurred before the contracts existed, not in violation of their terms after formation, and the covenant only governs conduct of parties after they have entered into a contract; and (2) the Plaintiffs' claim, based on a violation of the Massachusetts consumer protection law, was correctly dismissed as statutorily time-barred.

Fickewirth Benefits Advisors is an innovative firm focused on the long-term health and well-being of both companies and their employees.

Our expertise lies in the design, implementation, communication and administration of cost-effective benefit plans. Beyond that, we believe in not just managing benefits, but instead, managing the entirety of your total employee investment.

We welcome your inquiries.

This letter prepared, with the help of a nationally recognized tax authority, intends to promote interest in more comprehensive tax and estate planning. References are intentionally brief. If a topic interests you, you should investigate it more thoroughly with your qualified tax advisor. Effective tax and estate planning should involve competent advisors in relevant law, accounting, trusts, life insurance and investments. Please seek competent counsel to determine and satisfy your individual needs.

60 S. California St., 4th Floor - Ventura, CA 93001-2802
(805) 653-2030 Fax: (805) 653-2035
www.Fickewirth.com - E-mail: jlincicum@fickewirth.com