full personal residence exclusion of $250,000 – as long as one of them continue to use it as a personal residence AND this is specified in the divorce decree (a good reason to get along during the divorce negotiations).

Eva Rosenberg • Mar. 10, 2014

A TaxMama reader posted this hypothetical scenario:

> Susy and John buy a home in 1990; in 2000 they get a divorce.
> John stays in the home to raise the kids; Susy moves out and buys another home.
> Divorce decree says they are both "joint owners" of home until "kids move out" and they can sell the home.
> In 2009, the kids move out John sells home, to the tune of a $260,000 gain.

Tax professional verdict (that was provided to the couple):

– John, gets 121 exclusion.
– Susy, gets to report $130,000 gain.

> Susy, is really mad and thinks she is eligible for exclusion, due to the fact that "she was a nice gal" and let John raise the kids there. She thinks it's not fair that she gets hit with cap. gains.

What do YOU think? Is this fair? Heck, is it even correct? What would you tell your client in similar circumstances? After all, this happens all the time.

Good news, my friends. This is not correct.

Many, many years ago, one of my clients was about to buy a house with his girlfriend. I stepped in and prevented that, recommending that get a divorce first.

(Like that's a no-brainer!)

profits were well in excess of $250,000 – let's say, $400,000.

On the tax returns (his and hers), we reported the profits as a 50/50 split. She reported $200,000 – and so did he.

She lived in the house and used her Sec. 121 personal residence exclusion – and paid no tax. He didn't live in the house and used HIS Sec. 121 personal residence exclusion. – and paid no tax.

Huh? He used Sec 121 (d) (3) (B):

> **(B) Property used by former spouse pursuant to divorce decree, etc.**
>
> Solely for purposes of this section, an individual shall be treated as using property as such individual's principal residence during any period of ownership while such individual's spouse or former spouse is granted use of the property under a divorce or separation instrument (as defined in section 71 (b) (2)).

This is not an obscure part of the law. In fact, it's been around so long that even IRS Publication 523 has this information.

So the good news is, after a divorce, if both spouses stay on title, they can both take advantage of their full personal residence exclusion of $250,000 – as long as one of them continue to use it as a personal residence AND this is specified in the divorce decree (a good reason to get along during the divorce negotiations).

Incidentally, I sort of lied. My clients didn't split the proceeds 50/50. Just the income reporting. They actually split the proceeds 40/40 and gave 20% to their daughter for college.

Don't you just love it when a plan comes together?

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