

Compelled to Sell or Relenting to Rent?

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If you have recently purchased a new home and found yourself torn on what to do with your old home, there may be consequences to consider that you've never taken into account. From a tax perspective, there are numerous advantages to selling your old home and investing the proceeds in your investment portfolio:

- You could lose the \$500,000 home sale exclusion if you rent it for more than two years and then sell. Also, with the recent change in section 1031 rules, it is harder than ever to use a rental home in a like kind exchange and then move back into it later to take advantage of the home sale exclusion.
- One of the negative tax consequences of selling a rental property is that a portion of the profit will be taxed at your highest marginal income tax rate-- that portion is the amount you have previously depreciated. However, if you sold it when it was your residence, much of it would escape taxation (due to the home sale exclusion) and the rest of your capital gain would be taxed at 15% - there is no depreciation issue this way.
- Do the math - What could your portfolio generate in annual withdrawals using a sustainable withdrawal rate of 4-5% (based on your net proceeds from the sale of the house) vs. the net cash flow (excluding depreciation) from renting it out? Don't forget to deduct all expenses including mortgage payment (not just the interest that shows up on the tax return), property taxes, insurance, maintenance, fee to management company, etc.
- Portfolio appreciation is more tax efficient than rental income. Your capital gains (if held for the long-term, which we strongly recommend) and qualified dividends are taxed at 15%, whereas your rental income is taxed at your marginal income tax rate - 25%, 28%, 33%, or 35%!

There's another important factor to consider in this decision and it has nothing to do with taxes. What is your stage of life? If you are retired or approaching that age, perhaps you don't need the risks that accompany the role of landlord. Of course, those who have experience with these responsibilities may not dare to switch their allegiances from real estate to the stock market, "Dance with the date who brought you to the party." But the above points are important considerations pointing to the fact that some people would benefit by selling their old home rather than renting it.

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