HOW TO BUY LOW, SELL HIGH AND PAY NO TAXES

One of the best deals known to homeowners was delivered with the Tax Relief Act of 1997. That's the legislation that allows couples to keep up to $500,000 in profits from a home sale tax-free.

Gains from selling other long-term investments (those held more than one year) are currently taxed at a rate of 5% or 15%, depending on the taxpayer's income. (In fact, most taxpayers who have capital gains pay the 15% rate.) So, most people making $500,000 on the sale of most long-term investments would owe $75,000 in taxes. By contrast, a qualified married couple that makes $500,000 on the sale of a qualified home would not owe any tax at all on the sale.

No wonder some people have become "serial" buyers and sellers, using the tax exclusion as often as allowed. By understanding the rules, you too can get a long run of tax savings from your home purchases.

Know The Tax Code

The tax code allows single filers to exclude from taxation up to $250,000 of gain on the sale of a principal residence; the limit is $500,000 for married/joint filers. To qualify for the exclusion:

1. You must have owned and lived in the home two of the five years prior to the sale. The periods of ownership and use do not have to be consecutive. For example, you could live in the home six months, move somewhere else for 2-1/2 years, then move back to the home and live in it another 1-1/2 years before selling it.

2. You cannot have used the exclusion in the previous two years. Stated more positively, you can use the exclusion as often as every two years.

Time Your Sales

Here are a variety of strategies you can use to maximize this great gift from Uncle Sam.

Sell your residence (and buy another) before you reach the exclusion limit. If you keep your home longer, any further increase in value will be eroded by the capital-gains tax.

For example, say a single woman owns a $350,000 home and would have capital gains of exactly $250,000 if she sold it this year (thus, no tax would be owed). Instead, she decides to live in the home another three years, during which it appreciates 20%. Now she sells the home for $420,000, and declares capital gains of $320,000. Since $250,000 of the gains can still be excluded, she'll owe taxes on $70,000 — a $10,500 bill if she is taxed at the 15% rate.

In effect, she'll only pocket 17% appreciation (rather than 20%) from those three extra years of ownership ($70,000–$10,500 = $59,500; $59,500 ÷ $350,000 = 17%). Had she sold her home when she hit the exclusion limit and replaced it with a comparable one, she would have been building fully tax-excludable profit on the next home.

Watch The Markets

Using the tax exclusion as often as possible means purchasing homes that will gain value quickly — a good plan for any home buyer.

Buying in a hot market is one approach. Look for indications or predictions that homes in a particular area or neighborhood are likely to appreciate rapidly over the next several years. The faster your capital gains reach the exclusion limit, the more often you'll want to take advantage of the tax break.

Buying more expensive homes will bring you to the limit faster because the appreciation rate is applied to a larger amount. Consider, for example, 30% appreciation over three years on a $100,000 home. Ignoring buying, selling and home-improvement expenses for the moment, the profit would be $30,000 (30% x $100,000). The same rate of appreciation on a $400,000 home would yield a profit of $120,000 (30% x $400,000).

A third way to boost your capital gains is to buy homes that are selling below market. If the home is not in move-in condition but is basically sound and in a good location, you may be able to quickly increase its value through "sweat equity" and a small investment in paint, new hardware and minor repairs or improvements. Live in it for two years or more, then take the profits and sell it tax-free, replacing it with another home that will benefit from your hard work and good taste.

Double Up

Buy a second home. If you already own a home, you could buy another (perhaps with an eye to vacations or retirement) and rent it out for a few years. The rent income will help cover your ownership costs as your equity in the home grows and it appreciates (hopefully). Then you move into the second home at least two years before you plan to sell the second home.

Meanwhile, you can keep your old home and rent it out for up to three years before selling. (Remember,