Tax-Aware Planning: Capital Gains on Primary Residences Belong in the Plan

An overlooked exposure and **how advisors can get ahead of it**

Overview

Home values have risen sharply since Congress last adjusted the capital-gains exclusion on primary residences in 1997, and that exclusion has never been indexed to keep pace. As a result, **a growing share of homeowners, including the millionaire next door, now face a tax bill on their home that they never anticipated.** This is not a niche issue, and it is only expected to grow.

This creates an opportunity for advisors who see it coming. Tax-loss harvesting has traditionally been reserved for the wealthiest clients, deployed to offset equity gains. But that is not its only use case. These strategies can be useful tools for any client with meaningful appreciation in their home, not just ultra-HNW clients with concentrated stock positions. Many advisors are underestimating how many of their clients this proactive strategy applies to.

Implementation has historically been the barrier. Burney's tax-aware long-short strategy (TALS) can help. Our strategy, a single long ETF paired with 60-100 short positions, is easy to monitor and explain. There are ways around the frictions encountered elsewhere in the long-short space.

The takeaway for advisors is simple. **A proactive tax-loss harvesting strategy, deployed long before the home is sold, belongs in every financial plan,** not just the plans of the wealthiest clients.

The law is unchanged since 1997

The Taxpayer Relief Act of 1997 allowed an exclusion of $500K of capital gains for joint filers ($250K for single filers) on the sale of a primary residence. At the time, the median home price was $129K. Today it is over $440K. **The exclusion has never been adjusted for inflation.** Politicians have floated raising the caps, expanding eligibility, or exempting sales entirely, but no changes have been made.

A realistic example

Consider a couple in their 60s who purchased a home for $250K in 1980 and invested $200K in it over the years, resulting in a $450K cost basis. They want to sell today in what has become a high-cost-of- living area, at a current value of $1.5M. At a 20% tax rate, that equates to **a $110K tax bill even after the exclusion.**

Where the $1.5M sale price goes:

$450k	$500k	$550k
Cost Basis	Gain Excluded by Law	**Taxable Gain**

Total Gain	Taxable after Exclusion	Tax due at 20%
$1.05M	**$550k**	**$110k**

Note: This is an illustrative example only. For full details, view the IRS guidance.

This is a widespread issue

1 in 4

U.S. homes have **gained at least $250K in value** since purchase

10%

of homeowners **are above** the $500K exemption today

39%

of homeowners that NAR projects **will be above** the $500K exemption by 2035

Who is above the $500K exemption today?

Avg. Age
65yrs

Avg. income
$431K

Avg. Net Worth
$5.7M

Avg. Home Value
$1.4M

Sources: Redfin, National Association of Realtors (NAR), Yale Budget Lab

The numbers are starker for seniors who have been in their homes for many years and have benefited the most from rapid home price appreciation. Research from the American Enterprise Institute identifies **1.9 million senior households with home-equity gains exceeding their capital-gains exemption**. The numbers of households with gains in excess of the thresholds are higher in HCOL states

An astute advisor would consider the future tax implications as part of financial planning for all clients, not just their ultra-HNW clients.

Where tax-loss harvesting fits in

Tax loss harvesting is the practice of selling securities that have declined in value to realize a capital loss. These losses can be used to offset long-term and short-term capital gains, including the gain from a home sale above the exclusion amount. Unused losses carry forward indefinitely, and up to $3,000 per year can offset ordinary income.

The US equity markets provide ample opportunity to harvest losses. Since 2000, on average, 41% of S&P 500 stocks have finished the year in a loss. Even in up markets, there are ample opportunities to harvest losses and steadily accumulate a reserve of losses well before a client ever plans to sell a home. There are multiple strategies, including long-only and long-short strategies, which provide solutions for clients of all sizes and needs.

Tax-loss harvesting is traditionally viewed as a tool for offsetting equity gains, and typically only for the wealthiest clients. However, the capital gains tax on primary residences is a reminder that the use case is broader than that. Every client is happier paying less in taxes, and, as an advisor, you'll look wise for building this into the plan long before the tax bill comes due.

That said, advisors have historically reserved tax-loss for their wealthiest clients, since they tend to have the largest gains to offset. These strategies are complex and it is fair to ask whether the complexity is worth the risk for a HNW client. It is, but **implementation matters**. **The table below addresses advisor concerns about tax-aware long-short (TALS) implementation:**

Advisor Concern	Burney Implementation
Complexity for the client	Burney's TALS strategy uses a single ETF on the long side and 60–100 individual short positions, making it easy to monitor and explain.
Risks of shorting	Shorting can produce, theoretically, unlimited loss potential. But a well-run TALS operates at a tight tracking error relative to its long portfolio. The Burney short implementation is diversified and designed to behave with similar factor exposure to the long Burney-managed ETF. When planned for early enough, a modest 130-30 implementation limits the short exposure to a diversified 30% portfolio of more than 60 stocks.
Sacrificing returns to minimize taxes	Performance comes first, tax benefits are a byproduct. The ETF permits active management without tax trade-off, a feature that we at Burney believe is a better long term trade-off.
Whether the added cost is worth it	In May, we wrote a white paper simulating tax-loss harvesting strategies over rolling ten-year windows from 2000–2025. Using S&P 500 constituents and harvesting losses greater than 5% monthly we found that direct indexing strategies often do not generate enough tax benefits to offset their added cost. 130-30 strategies with alpha, however, generated net tax losses averaging 40– 60% of the initial amount invested over a ten-year period. In several windows, the net loss exceeded 100% of the initial portfolio.
Custodial friction	Recent headlines have highlighted challenges implementing long-short strategies at certain custodians. Others custodians have been more supportive with lower minimums and fewer gates to get started.

The catch is timing. Losses accumulate over years, not weeks. A strategy started after a client decides to sell arrives too late to help. **The advisors who benefit the most are the ones who stay one step ahead.**

The takeaway

As home prices rise and Baby Boomers move through retirement and downsizing decisions, more clients will face capital-gains bills on primary residences they never anticipated. **This is an opportunity for advisors to get ahead of the problem. A proactive tax-loss harvesting strategy belongs in every financial plan,** not just the wealthiest clients, and not just for those about to sell their home. Effective tax planning, started early, can meaningfully reduce that bill. **Burney's tax-aware long-short strategy (TALS) offers a viable solution,** it's easy to explain, puts performance first, and is suitable for a wide range of clients, not just the ultra-HNW.

Learn more about our Tax-aware long short strategy at burneyadvisorservices.com.

Important Disclosures

HYPOTHETICAL PERFORMANCE — IMPORTANT NOTICE
The analyses, charts, and portfolio projections contained in the White Paper are based entirely on hypothetical simulations and modeled outcomes. They do not represent the actual performance of any investment product, account, fund, or strategy managed by The Burney Company or any affiliated entity. No actual client assets were managed using this strategy during the periods depicted. Hypothetical or simulated performance results have certain inherent limitations. No representation is being made that any account will, or is likely to, achieve profits or losses similar to those shown.

130/30 DISCLOSURES
We execute this strategy at two custodian firms: Interactive Brokers and Schwab. Both custodians offer competitive margin rates vs other custodians. Clients seeking to utilize this strategy will need to sign a margin agreement with the custodian firm. The strategy can only be executed in taxable accounts with a minimum investment of $250k.

The primary risks associated with this strategy include the following:

- Unlimited risk of loss from short selling. Unlike long positions, where losses are limited to the initial investment, the price of a stock sold short can rise indefinitely, potentially causing rapid and unlimited losses. The Burney Company employs various measures to reduce this risk, but losses can still occur.
- Leverage and margin risk. Long-short strategies use margin to boost exposure, increasing both potential gains and losses. A decline in stock value can trigger margin calls.
- Tracking error and portfolio risk. There is potential for tracking error due to the performance of our stock selection model. Success depends on the portfolio manager's ability to choose both winning longs and losing shorts. Poor timing or incorrect analysis can lead to losses on either side. Additionally, in volatile market conditions, the assumed hedge between long and short positions may break down, leaving the portfolio vulnerable to broad market downturns.
- Costs and tax implications. This portfolio incurs additional expenses, including margin charges, as detailed in the margin agreement. Additionally, closing out positions can lead to significant short-term capital gains tax liabilities that may not be fully offset.
- Liquidity risks. Some short positions may become difficult to borrow or cover, particularly in volatile markets, making unwinding difficult.

The strategy is intended for sophisticated investors with aggressive or moderately aggressive risk tolerances who understand its complexity and the potential for unlimited losses associated with short selling. Past performance is not indicative of future results. All investments involve risk, including loss of principal.

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