

realized from the sale is \$256,000. A and B are each eligible to exclude \$128,000 of gain because the amount of realized gain allocable to each of them from the sale does not exceed each taxpayer's available limitation amount of \$250,000.

*Example 2.* The facts are the same as in *Example 1*, except that A and B are married taxpayers who file a joint return for the taxable year of the sale. A and B are eligible to exclude the entire amount of realized gain (\$256,000) from gross income because the gain realized from the sale does not exceed the limitation amount of \$500,000 available to A and B as taxpayers filing a joint return.

*Example 3.* During 1999, married Taxpayers H and W each sell a residence that each had separately owned and used as a principal residence before their marriage. Each spouse meets the ownership and use tests for his or her respective residence. Neither spouse meets the use requirement for the other spouse's residence. H and W file a joint return for the year of the sales. The gain realized from the sale of H's residence is \$200,000. The gain realized from the sale of W's residence is \$300,000. Because the ownership and use requirements are met for each residence by each respective spouse, H and W are each eligible to exclude up to \$250,000 of gain from the sale of their individual residences. However, W may not use H's unused exclusion to exclude gain in excess of her limitation amount. Therefore, H and W must recognize \$50,000 of the gain realized on the sale of W's residence.

*Example 4.* Married Taxpayers H and W sell their residence and file a joint return for the year of the sale. W, but not H, satisfies the requirements of section 121. They are eligible to exclude up to \$250,000 of the gain from the sale of the residence because that is the sum of each spouse's dollar limitation amount determined on a separate basis as if they had not been married (\$0 for H, \$250,000 for W).

*Example 5.* Married Taxpayers H and W have owned and used their principal residence since 1998. On February 16, 2001, H dies. On September 24, 2001, W sells the residence and realizes a gain of \$350,000. Pursuant to section 6013(a)(3), W and H's executor make a joint return for 2001. All \$350,000 of the gain from the sale of the residence may be excluded.

*Example 6.* Assume the same facts as *Example 5*, except that W does not sell the residence until January 31, 2002. Because W's filing status for the taxable year of the sale is single, the special rules for joint returns under paragraph (a)(3) of this section do not apply and W may exclude only \$250,000 of the gain.

(b) *Application of section 121 to only 1 sale or exchange every 2 years—(1) In general.* Except as otherwise provided in § 1.121-3 (relating to the reduced

maximum exclusion), a taxpayer may not exclude from gross income gain from the sale or exchange of a principal residence if, during the 2-year period ending on the date of the sale or exchange, the taxpayer sold or exchanged other property for which gain was excluded under section 121. For purposes of this paragraph (b)(1), any sale or exchange before May 7, 1997, is disregarded.

(2) *Example.* The following example illustrates the rules of this paragraph (b). The example assumes that § 1.121-3 (relating to the reduced maximum exclusion) does not apply to the sale of the property. The example is as follows:

*Example.* Taxpayer A owns a townhouse that he uses as his principal residence for 2 full years, 1998 and 1999. A buys a house in 2000 that he owns and uses as his principal residence. A sells the townhouse in 2002 and excludes gain realized on its sale under section 121. A sells the house in 2003. Although A meets the 2-year ownership and use requirements of section 121, A is not eligible to exclude gain from the sale of the house because A excluded gain within the last 2 years under section 121 from the sale of the townhouse.

(c) *Effective date.* This section is applicable for sales and exchanges on or after December 24, 2002. For rules on electing to apply the provisions of this section retroactively, see § 1.121-4(j).

[T.D. 9030, 67 FR 78361, Dec. 24, 2002]

### § 1.121-3 Reduced maximum exclusion for taxpayers failing to meet certain requirements.

(a) *In general.* In lieu of the limitation under section 121(b) and § 1.121-2, a reduced maximum exclusion limitation may be available for a taxpayer who sells or exchanges property used as the taxpayer's principal residence but fails to satisfy the ownership and use requirements described in § 1.121-1(a) and (c) or the 2-year limitation described in § 1.121-2(b).

(b) through (f) [Reserved]. For further guidance, see § 1.121-3T(b) through (f).

(g) *Computation of reduced maximum exclusion.* (1) The reduced maximum exclusion is computed by multiplying the maximum dollar limitation of \$250,000 (\$500,000 for certain joint filers) by a

## § 1.121-3T

## 26 CFR Ch. I (4-1-04 Edition)

fraction. The numerator of the fraction is the shortest of the period of time that the taxpayer owned the property during the 5-year period ending on the date of the sale or exchange; the period of time that the taxpayer used the property as the taxpayer's principal residence during the 5-year period ending on the date of the sale or exchange; or the period of time between the date of a prior sale or exchange of property for which the taxpayer excluded gain under section 121 and the date of the current sale or exchange. The numerator of the fraction may be expressed in days or months. The denominator of the fraction is 730 days or 24 months (depending on the measure of time used in the numerator).

(2) *Examples.* The following examples illustrate the rules of this paragraph (g):

*Example 1.* Taxpayer A purchases a house that she uses as her principal residence. Twelve months after the purchase, A sells the house due to a change in place of her employment. A has not excluded gain under section 121 on a prior sale or exchange of property within the last 2 years. A is eligible to exclude up to \$125,000 of the gain from the sale of her house ( $12/24 \times \$250,000$ ).

*Example 2.* (i) Taxpayer H owns a house that he has used as his principal residence since 1996. On January 15, 1999, H and W marry and W begins to use H's house as her principal residence. On January 15, 2000, H sells the house due to a change in W's place of employment. Neither H nor W has excluded gain under section 121 on a prior sale or exchange of property within the last 2 years.

(ii) Because H and W have not each used the house as their principal residence for at least 2 years during the 5-year period preceding its sale, the maximum dollar limitation amount that may be claimed by H and W will not be \$500,000, but the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. (See § 1.121-2(a)(3)(ii).)

(iii) H is eligible to exclude up to \$250,000 of gain because he meets the requirements of section 121. W is not eligible to exclude the maximum dollar limitation amount. Instead, because the sale of the house is due to a change in place of employment, W is eligible to claim a reduced maximum exclusion of up to \$125,000 of the gain ( $365/730 \times \$250,000$ ). Therefore, H and W are eligible to exclude up to \$375,000 of gain ( $\$250,000 + \$125,000$ ) from the sale of the house.

(h) [Reserved]. For further guidance, see § 1.121-3T(h).

(i)-(k) [Reserved].

(l) *Effective date.* This section is applicable for sales and exchanges on or after December 24, 2002. For rules on electing to apply the provisions of this section retroactively, see § 1.121-4(j).

[T.D. 9030, 67 FR 78361, Dec. 24, 2002]

### § 1.121-3T Reduced maximum exclusion for taxpayers failing to meet certain requirements (temporary).

(a) [Reserved] For further guidance, see § 1.121-3(a).

(b) *Primary reason for sale or exchange.* In order for a taxpayer to claim a reduced maximum exclusion under section 121(c), the sale or exchange must be by reason of a change in place of employment, health, or unforeseen circumstances. A sale or exchange is by reason of a change in place of employment, health, or unforeseen circumstances only if the primary reason for the sale or exchange is a change in place of employment (within the meaning of paragraph (c) of this section), health (within the meaning of paragraph (d) of this section), or unforeseen circumstances (within the meaning of paragraph (e) of this section). Whether the requirements of this section are satisfied depends upon all the facts and circumstances. If the taxpayer qualifies for a safe harbor described in this section, the taxpayer's primary reason is deemed to be a change in place of employment, health, or unforeseen circumstances. If the taxpayer does not qualify for a safe harbor, factors that may be relevant in determining the taxpayer's primary reason for the sale or exchange include (but are not limited to) the extent to which—

(1) The sale or exchange and the circumstances giving rise to the sale or exchange are proximate in time;

(2) The suitability of the property as the taxpayer's principal residence materially changes;

(3) The taxpayer's financial ability to maintain the property materially changes;

(4) The taxpayer uses the property as the taxpayer's residence during the period of the taxpayer's ownership of the property;

(5) The circumstances giving rise to the sale or exchange are not reasonably foreseeable when the taxpayer begins