

§ 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

using the property as the taxpayer's principal residence; and

(6) The circumstances giving rise to the sale or exchange occur during the period of the taxpayer's ownership and use of the property as the taxpayer's principal residence.

(c) *Sale or exchange by reason of a change in place of employment*—(1) *In general.* A sale or exchange is by reason of a change in place of employment if, in the case of a qualified individual described in paragraph (f) of this section, the primary reason for the sale or exchange is a change in the location of the individual's employment.

(2) *Distance safe harbor.* The primary reason for the sale or exchange is deemed to be a change in place of employment (within the meaning of paragraph (c)(1) of this section) if—

(i) The change in place of employment occurs during the period of the taxpayer's ownership and use of the property as the taxpayer's principal residence; and

(ii) The individual's new place of employment is at least 50 miles farther from the residence sold or exchanged than was the former place of employment, or, if there was no former place of employment, the distance between the individual's new place of employment and the residence sold or exchanged is at least 50 miles.

(3) *Employment.* For purposes of this paragraph (c), *employment* includes the commencement of employment with a new employer, the continuation of employment with the same employer, and the commencement or continuation of self-employment.

(4) *Examples.* The following examples illustrate the rules of this paragraph (c):

*Example 1.* A is unemployed and owns a townhouse that she has owned and used as her principal residence since 2002. In 2003 A obtains a job that is 54 miles from her townhouse, and she sells the townhouse. Because the distance between A's new place of employment and the townhouse is at least 50 miles, the sale is within the safe harbor of paragraph (c)(2) of this section and A is entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 2.* B is an officer in the United States Air Force stationed in Florida. B purchases a house in Florida in 2001. In May 2002 B moves out of his house to take a 3-year as-

signment in Germany. B sells his house in January 2003. Because B's new place of employment in Germany is at least 50 miles farther from the residence sold than is B's former place of employment in Florida, the sale is within the safe harbor of paragraph (c)(2) of this section and B is entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 3.* C is employed by Employer R at R's Philadelphia office. C purchases a house in February 2001 that is 35 miles from R's Philadelphia office. In May 2002 C begins a temporary assignment at R's Wilmington office that is 72 miles from C's house, and moves out of the house. In June 2004 C is assigned to work in R's London office, and as a result, sells her house in August 2004. The sale of the house is not within the safe harbor of paragraph (c)(2) of this section by reason of the change in place of employment from Philadelphia to Wilmington because the Wilmington office is not 50 miles farther from C's house than is the Philadelphia office. Furthermore, the sale is not within the safe harbor by reason of the change in place of employment to London because C is not using the house as her principal residence when she moves to London. However, C is entitled to claim a reduced maximum exclusion under section 121(c)(2) because, under the facts and circumstances, the primary reason for the sale is the change in C's place of employment.

*Example 4.* In July 2002 D buys a condominium that is 5 miles from her place of employment and uses it as her principal residence. In February 2003 D, who works as an emergency medicine physician, obtains a job that is located 51 miles from D's condominium. D may be called in to work unscheduled hours and, when called, must be able to arrive at work quickly. Therefore, D sells her condominium and buys a townhouse that is 4 miles from her new place of employment. Because D's new place of employment is only 46 miles farther from the condominium than is D's former place of employment, the sale is not within the safe harbor of paragraph (c)(2) of this section. However, D is entitled to claim a reduced maximum exclusion under section 121(c)(2) because, under the facts and circumstances, the primary reason for the sale is the change in D's place of employment.

(d) *Sale or exchange by reason of health*—(1) *In general.* A sale or exchange is by reason of health if the primary reason for the sale or exchange is to obtain, provide, or facilitate the diagnosis, cure, mitigation, or treatment of disease, illness, or injury of a qualified individual described in paragraph (f) of this section, or to obtain or provide medical or personal care for a

qualified individual suffering from a disease, illness, or injury. A sale or exchange that is merely beneficial to the general health or well-being of the individual is not a sale or exchange by reason of health.

(2) *Physician's recommendation safe harbor.* The primary reason for the sale or exchange is deemed to be health if a physician (as defined in section 213(d)(4)) recommends a change of residence for reasons of health (as defined in paragraph (d)(1) of this section).

(3) *Examples.* The following examples illustrate the rules of this paragraph (d):

*Example 1.* In 2002 A buys a house that she uses as her principal residence. A is injured in an accident and is unable to care for herself. As a result, A sells her house in 2003 and moves in with her daughter so that the daughter can provide the care that A requires as a result of her injury. Because, under the facts and circumstances, the primary reason for the sale of A's house is A's health, A is entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 2.* H's father has a chronic disease. In 2002 H and W purchase a house that they use as their principal residence. In 2003 H and W sell their house in order to move into the house of H's father so that they can provide the care he requires as a result of his disease. Because, under the facts and circumstances, the primary reason for the sale of their house is the health of H's father, H and W are entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 3.* H and W purchase a house in 2002 that they use as their principal residence. Their son suffers from a chronic illness that requires regular medical care. Later that year their doctor recommends that their son begin a new treatment that is available at a medical facility 100 miles away from their residence. In 2003 H and W sell their house to be closer to the medical facility. Because, under the facts and circumstances, the primary reason for the sale is to facilitate the treatment of their son's chronic illness, H and W are entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 4.* B, who has chronic asthma, purchases a house in Minnesota in 2002 that he uses as his principal residence. B's doctor tells B that moving to a warm, dry climate would mitigate B's asthma symptoms. In 2003 B sells his house and moves to Arizona to relieve his asthma symptoms. The sale is within the safe harbor of paragraph (d)(2) of this section and B is entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 5.* In 2002 H and W purchase a house in Michigan that they use as their principal residence. H's doctor tells H that he should get more exercise, but H is not suffering from any disease that can be treated or mitigated by exercise. In 2003 H and W sell their house and move to Florida so that H can increase his general level of exercise by playing golf year-round. Because the sale of the house is merely beneficial to H's general health, the sale of the house is not by reason of H's health. H and W are not entitled to claim a reduced maximum exclusion under section 121(c)(2).

(e) *Sale or exchange by reason of unforeseen circumstances—(1) In general.* A sale or exchange is by reason of unforeseen circumstances if the primary reason for the sale or exchange is the occurrence of an event that the taxpayer does not anticipate before purchasing and occupying the residence.

(2) *Specific event safe harbors.* The primary reason for the sale or exchange is deemed to be unforeseen circumstances (within the meaning of paragraph (e)(1) of this section) if any of the events specified in paragraphs (e)(2)(i) through (iii) of this section occur during the period of the taxpayer's ownership and use of the residence as the taxpayer's principal residence—

(i) The involuntary conversion of the residence;

(ii) Natural or man-made disasters or acts of war or terrorism resulting in a casualty to the residence (without regard to deductibility under section 165(h));

(iii) In the case of a qualified individual described in paragraph (f) of this section—

(A) Death;

(B) The cessation of employment as a result of which the individual is eligible for unemployment compensation (as defined in section 85(b));

(C) A change in employment or self-employment status that results in the taxpayer's inability to pay housing costs and reasonable basic living expenses for the taxpayer's household (including amounts for food, clothing, medical expenses, taxes, transportation, court-ordered payments, and expenses reasonably necessary to the production of income, but not for the maintenance of an affluent or luxurious standard of living);

(D) Divorce or legal separation under a decree of divorce or separate maintenance; or

(E) Multiple births resulting from the same pregnancy; or

(iv) An event determined by the Commissioner to be an unforeseen circumstance to the extent provided in published guidance of general applicability or in a ruling directed to a specific taxpayer.

(3) *Examples.* The following examples illustrate the rules of this paragraph (e):

*Example 1.* In 2003 A buys a house in California. After A begins to use the house as her principal residence, an earthquake causes damage to A's house. A sells the house in 2004. The sale is within the safe harbor of paragraph (e)(2)(ii) of this section and A is entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 2.* H works as a teacher and W works as a pilot. In 2003 H and W buy a house that they use as their principal residence. Later that year W is furloughed from her job for six months. H and W are unable to pay their mortgage during the period W is furloughed. H and W sell their house in 2004. The sale is within the safe harbor of paragraph (e)(2)(iii)(C) of this section and H and W are entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 3.* In 2003 H and W buy a two-bedroom condominium that they use as their principal residence. In 2004 W gives birth to twins and H and W sell their condominium and buy a four-bedroom house. The sale is within the safe harbor of paragraph (e)(2)(iii)(E) of this section, and H and W are entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 4.* B buys a condominium in 2003 and uses it as his principal residence. B's monthly condominium fee is \$X. Three months after B moves into the condominium, the condominium association decides to replace the building's roof and heating system. Six months later, B's monthly condominium fee doubles. B sells the condominium in 2004 because B is unable to pay the new condominium fee along with the monthly mortgage payment. The safe harbors of paragraph (e)(2) of this section do not apply. However, under the facts and circumstances, the primary reason for the sale is unforeseen circumstances, and B is entitled to claim a reduced maximum exclusion under section 121(c)(2).

*Example 5.* In 2003 C buys a house that he uses as his principal residence. The property is located on a heavily trafficked road. C sells the property in 2004 because the traffic is more disturbing than he expected. C is not

entitled to claim a reduced maximum exclusion under section 121(c)(2) because the safe harbors of paragraph (e)(2) of this section do not apply and, under the facts and circumstances, the traffic is not an unforeseen circumstance.

*Example 6.* In 2003 D and her fiance E buy a house and live in it as their principal residence. In 2004 D and E cancel their wedding plans and E moves out of the house. Because D cannot afford to make the monthly mortgage payments alone, D and E sell the house in 2004. The safe harbors of paragraph (e)(2) of this section do not apply. However, under the facts and circumstances, the primary reason for the sale is unforeseen circumstances, and D and E are each entitled to claim a reduced maximum exclusion under section 121(c)(2).

(f) *Qualified individual.* For purposes of this section, *qualified individual* means—

- (1) The taxpayer;
- (2) The taxpayer's spouse;
- (3) A co-owner of the residence;

(4) A person whose principal place of abode is in the same household as the taxpayer; or

(5) For purposes of paragraph (d) of this section, a person bearing a relationship specified in sections 152(a)(1) through 152(a)(8) (without regard to qualification as a dependent) to a qualified individual described in paragraphs (f)(1) through (4) of this section, or a descendant of the taxpayer's grandparent.

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

(h) *Election to apply regulations retroactively.* Taxpayers who would otherwise qualify under this section to exclude gain from a sale or exchange before December 24, 2002 but on or after May 7, 1997, may elect to apply all of the provisions of this section for any years for which the period of limitations under section 6511 has not expired. The taxpayer makes the election under this paragraph (h) by filing a return for the taxable year of the sale or exchange that does not include the gain from the sale or exchange of the taxpayer's principal residence in the taxpayer's gross income. Taxpayers who have filed a return for the taxable year of the sale or exchange may elect to apply all the provisions of this section for any years for which the period of limitations under section 6511 has

not expired by filing an amended return.

(i) through (j) [Reserved]. See § 1.121-3(i) through (j).

(k) *Audit protection.* The Internal Revenue Service will not challenge a taxpayer's position that a sale or exchange of a principal residence that occurred before December 24, 2002 but on or after May 7, 1997, qualifies for the reduced maximum exclusion under section 121(c) if the taxpayer has made a reasonable, good faith effort to comply with the requirements of section 121(c) and if the sale or exchange otherwise qualifies under section 121.

(l) *Effective date.* For the applicability of this section, see § 1.121-3(l).

[T.D. 9031, 67 FR 78369, Dec. 24, 2002]

**§ 1.121-4 Special rules.**

(a) *Property of deceased spouse—(1) In general.* For purposes of satisfying the ownership and use requirements of section 121, a taxpayer is treated as owning and using property as the taxpayer's principal residence during any period that the taxpayer's deceased spouse owned and used the property as a principal residence before death if—

(i) The taxpayer's spouse is deceased on the date of the sale or exchange of the property; and

(ii) The taxpayer has not remarried at the time of the sale or exchange of the property.

(2) *Example.* The provisions of this paragraph (a) are illustrated by the following example. 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 H has owned and used a house as his principal residence since 1987. H and W marry on July 1, 1999 and from that date they use H's house as their principal residence. H dies on August 15, 2000, and W inherits the property. W sells the property on September 1, 2000, at which time she has not remarried. Although W has owned and used the house for less than 2 years, W will be considered to have satisfied the ownership and use requirements of section 121 because W's period of ownership and use includes the period that H owned and used the property before death.

(b) *Property owned by spouse or former spouse—(1) Property transferred to indi-*

*vidual from spouse or former spouse.* If a taxpayer obtains property from a spouse or former spouse in a transaction described in section 1041(a), the period that the taxpayer owns the property will include the period that the spouse or former spouse owned the property.

(2) *Property used by spouse or former spouse.* A taxpayer is treated as using property as the taxpayer's principal residence for any period that the taxpayer has an ownership interest in the property and the taxpayer's spouse or former spouse is granted use of the property under a divorce or separation instrument (as defined in section 71(b)(2)), provided that the spouse or former spouse uses the property as his or her principal residence.

(c) *Tenant-stockholder in cooperative housing corporation.* A taxpayer who holds stock as a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b)(1) and (2)) may be eligible to exclude gain under section 121 on the sale or exchange of the stock. In determining whether the taxpayer meets the requirements of section 121, the ownership requirements are applied to the holding of the stock and the use requirements are applied to the house or apartment that the taxpayer is entitled to occupy by reason of the taxpayer's stock ownership.

(d) *Involuntary conversions—(1) In general.* For purposes of section 121, the destruction, theft, seizure, requisition, or condemnation of property is treated as a sale of the property.

(2) *Application of section 1033.* In applying section 1033 (relating to involuntary conversions), the amount realized from the sale or exchange of property used as the taxpayer's principal residence is treated as being the amount determined without regard to section 121, reduced by the amount of gain excluded from the taxpayer's gross income under section 121.

(3) *Property acquired after involuntary conversion.* If the basis of the property acquired as a result of an involuntary conversion is determined (in whole or in part) under section 1033(b) (relating to the basis of property acquired through an involuntary conversion),