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This is in response to a letter received on June 6, 2004, requesting a ruling that Taxpayer is entitled to exclude gain from the sale of the Townhouse under section 121(c) of the Internal Revenue Code.

FACTS

Taxpayer is employed as a police officer. In Month 1, Year 1, Taxpayer and Spouse signed a contract to purchase the Townhouse. At the time of signing the contract, they were required to pay a nonrefundable deposit of Amount \$. In Month 2, Year 2, Taxpayer and Spouse settled on the Townhouse and started using it as their principal residence.

After Taxpayer and Spouse signed the purchase contract but three months prior to the settlement, Taxpayer completed a test in order to compete for a position within the K-9 unit of Taxpayer's police force. The K-9 unit represents only three percent of the entire police force and very few officers are selected to train for a position within the K-9 unit. After Taxpayer and Spouse started using the Townhouse as their principal residence, Taxpayer received notification that Taxpayer was selected to become a K-9 officer.

According to Taxpayer's supplemental representations, a K-9 officer is required to care for a dog and maintain a 6 foot by 9 foot kennel at the officer's residence. The homeowners association for Taxpayer's townhouse does not permit its residents to maintain a kennel. Consequently, Taxpayer and Spouse sold the Townhouse before they had owned and used the property as their principal residence for two years.

LAW & ANALYSIS

Section 121(a) of the Code provides that a taxpayer's gross income will not include gain from the sale or exchange of property if, during the five-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more. The full exclusion is available only once every two years.

Section 121(b) of the Code provides that the maximum exclusion amount is \$500,000 if (1) a husband and wife file a joint return for the year of the sale, (2) both spouses meet the 2-year use test, (3) at least one of the spouses meets the 2-year ownership test, and (4) neither spouse used the section 121 exclusion during the last two years.

Section 121(c) of the Code provides for a reduced maximum exclusion for taxpayers who fail to satisfy the ownership and use tests or the limit of one sale every two years if the primary reason for sale or exchange is a change in place of employment, health, or unforeseen circumstances.

Section 1.121-3T(e) of the temporary Income Tax Regulations provides that 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. A taxpayer's primary reason for the sale or exchange is deemed to be unforeseen circumstances if one of the safe harbor events, such as involuntary conversion of the residence, death, or divorce, occurs during the period of the taxpayer's ownership and use of the residence as the taxpayer's principal residence. In addition, the Commissioner may designate other events or situations as unforeseen circumstances in published guidance of general applicability or in a ruling directed to a specific taxpayer.

Section 1.121-3(g) of the Income Tax Regulations provides that the reduced maximum exclusion is computed by multiplying the maximum dollar limitation of \$250,000 (\$500,000 for certain joint filers) by a fraction. The numerator of the fraction is the shortest of the following periods: (1) the period of time that the taxpayer owned the property during the 5-year period ending on the date of the sale or exchange, (2) 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 (3) the period of time between the date of a prior sale or exchange of property for which the taxpayer excluded gain under § 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).

Based on the facts as represented and the authority set forth above, we conclude that Taxpayer's primary reason for the sale of the Residence was an unforeseen circumstance. Consequently, even though Taxpayer sold the Residence before Taxpayer had owned and used it as Taxpayer's principal residence for two of the preceding five years, Taxpayer is entitled to exclude gain up to the reduced maximum exclusion amount under section 121(c) of the Code.

Except as specifically ruled upon above, no opinion is expressed or implied regarding the income tax consequences of any transaction, or any item discussed or referenced in this letter. In addition, no opinion is expressed or implied as to whether Taxpayer has used the Residence as Taxpayer's principal residence.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

J. Charles Strickland, Jr.
Senior Technician Reviewer, Branch 5
(Income Tax & Accounting)