



Fall 2016 Bulletin

TAXPAYERS WHO SOLD CONDO AFTER HAVING SECOND CHILD QUALIFY FOR REDUCED GAIN EXCLUSION

In a private letter ruling (PLR), the IRS determined that a married couple who had a daughter at the time they bought their 2-bedroom condo, then later had a son, qualified for the reduced maximum exclusion of gain from the sale of their home. The IRS concluded that the suitability of the condo as their principal residence materially changed as a result of the occurrence of unforeseen circumstances and was the primary reason for the sale.

Background. As you know, a taxpayer can exclude up to \$250,000 of gain (\$500,000 for married taxpayers filing jointly) from the sale or exchange of a home owned and used by him or her as a principal residence for at least two of the five years before the sale. The full \$250,000/\$500,000 exclusion does not apply if, within the 2-year period ending on the sale date, there was another home sale by the taxpayer to which the exclusion applied (Code Sec. 121(b)(3)), but the taxpayer may still be eligible for a reduced maximum exclusion (essentially, a prorated exclusion) when his or her failure to satisfy the Code's ownership and use requirements is primarily due to the occurrence of unforeseen circumstances.

The Internal Revenue Code states that all of the facts and circumstances of a sale will determine whether the primary reason for the sale is the occurrence of unforeseen circumstances. Factors that may be relevant in determining the primary reason for a sale include:

1. The suitability of the property as the taxpayer's residence materially changes;
2. The circumstances giving rise to the sale are not reasonably foreseeable, when the

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

3. The circumstances giving rise to the sale occur during the period of the taxpayer's ownership and use of the property as the taxpayer's principal residence.

There are also a number of safe harbors under which a taxpayer is deemed to have sold the residence due to an unforeseen circumstance, if a specified event, such as death, divorce, or multiple births from the same pregnancy, occurs during the period of his or her ownership and use of the residence as a principal residence.

Facts. Taxpayers were married and had a daughter when they purchased Residence 1 on Date 1. Residence 1 is a condominium with two small bedrooms and two baths. The child's bedroom also served as the Husband's home office as well as a guest room. After the purchase of Residence 1, the Wife became pregnant and gave birth to a son. On Date 2, Taxpayers moved out of Residence 1, and on Date 3, Taxpayers sold Residence 1. They requested a ruling that the gain on the sale of Residence 1 may be excluded under the reduced maximum exclusion.

Favorable ruling. The PLR concluded that the occurrence of unforeseen circumstances was the primary reason for the sale and that the suitability of Residence 1 as the Taxpayers' principal residence materially changed. Accordingly, the gain on the sale of Residence 1 can be excluded under the reduced maximum exclusion of gain.

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