**8584. Are there circumstances in which a taxpayer can exclude the gain on the sale of a personal residence even though the taxpayer fails to meet the requirements otherwise required for exclusion treatment?**

If a taxpayer fails to meet the ownership and use requirements, or sells multiple primary residences within the two-year period, a portion of the exclusion (as discussed below) may still be available if the primary residence is sold for reasons that were *primarily* caused by a change in the taxpayer’s place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.[[1]](#footnote-1) In determining a taxpayer’s primary reason for selling a primary residence, the following factors are considered:

(1) Whether the sale and the circumstances giving rise to the sale are proximate in time;

(2) Material changes in the suitability of the property as the taxpayer’s primary residence;

(3) Impairments to the taxpayer’s financial ability to maintain the property;

(4) Whether the taxpayer has used the property as his residence during the period of ownership;

(5) Whether or not the circumstances giving rise to the sale are reasonably foreseeable at the time when the taxpayer began using the property as his or her primary residence;

(6) Whether or not the circumstances giving rise to the sale occur during the period of the taxpayer’s ownership and use of the property as his or her principal residence.[[2]](#footnote-2)

For taxpayers claiming a Section 121 exclusion based on a change in place of employment, a safe harbor applies if the change in employment occurs during the period of the taxpayer’s ownership and use of the property as a principle residence and the taxpayer’s new place of employment is at least 50 miles from the residence that was sold.[[3]](#footnote-3)

Similarly, for taxpayers claiming the exclusion based on health reasons, a safe harbor exists for taxpayers whose physician has recommended a change in residence for health reasons.[[4]](#footnote-4)

The exception for a sale based on “unforeseen circumstances” may be met based on any of the following specific events:

(1) An involuntary conversion of the residence;

(2) Natural or man-made disasters, or acts of war or terrorism, resulting in a casualty to the residence;

(3) The death of the taxpayer;

(4) Loss of employment resulting in eligibility for unemployment compensation;

(5) Change in employment that results in the taxpayer’s inability to pay housing costs and reasonable basic living expenses for the taxpayer’s household;

(6) Divorce or legal separation; or

(7) Multiple births resulting from the same pregnancy.[[5]](#footnote-5)

The taxpayer does *not* qualify for the exclusion based on unforeseen circumstances if the unforeseen circumstance is an *improvement* in the taxpayer’s financial condition.[[6]](#footnote-6)

*Example:* In April 2013 George buys a house that he uses as his principal residence. He sells it in October 2014 because the house has greatly appreciated in value and mortgage rates have substantially decreased, making a bigger house affordable. The specific event safe harbors described above do not apply. Under the facts and circumstances, the primary reasons for the sale of the house--the changes in George's house value and in the mortgage rates--are an improvement in his financial circumstances. However, an improvement in financial circumstances, even if the result of unforeseen circumstances, does not qualify for the reduced maximum exclusion by reason of unforeseen circumstances under IRC section 121(c)(2). [[7]](#footnote-7)

For purposes of determining the reduced exclusion, the maximum amount of gain that would have been excluded but for the premature sale of the primary residence is multiplied by a fraction. The numerator of the fraction equals the shorter of (1) the aggregate periods during the five-year period ending on the date of the sale or exchange that the property has been owned or used by the taxpayer as a principal residence, or (2) the period after the date of the most recent prior sale or exchange by the taxpayer to which the two-year limitation applied and the date of the sale or exchange. The denominator equals two years.[[8]](#footnote-8)

*Example:* On July 2, 2010, Ashley, a single taxpayer, purchased her first primary residence for $150,000. More than two years later, on August 15, 2012, Ashley sold the home for $200,000. Because she met all the requirements of IRC Section 121, Ashley excluded the entire amount of her gain. On September 15, 2012, Ashley purchased a new primary residence for $250,000. Nine months later, on June 15, 2013, Ashley sold the new primary residence for $275,000 because she lost her job and had to take a new job in a different state.

Although the sale of the new primary residence does not qualify for the full exclusion because Ashley used and owned the home for only nine months, the unforeseen circumstance of losing her job that necessitated her relocation qualify her for the exclusion. Applying the partial exclusion formula, her $250,000 maximum exclusion (single taxpayer) is multiplied by 9/24, or $93,750. This is because, per the formula, the numerator is the lesser of the time between the date of the sale of the previous home (August 15 or ten months to the June 15 sale date) or the time she used and owned the latter residence as her primary residence and the date of the sale (September 15 or nine months until the June 15 sale date). For that reason, Ashley may exclude the entire amount of her gain ($25,000) because it was less than the reduced exclusion amount ($93,750).

If the taxpayer is mentally or physically incapable of caring for himself, and the taxpayer owned and used the property as a principal residence for an aggregate of one year during the five-year period ending on the date of the sale or exchange, an exception to the use requirement applies. Such a taxpayer will be *treated as using* the property during any time within the five-year period that the taxpayer *owns* the property and resides in a facility (including a nursing home) licensed by the state or a political subdivision to care for such an individual.[[9]](#footnote-9)

1. . IRC Sec. 121(c)(2). [↑](#footnote-ref-1)
2. . Treas. Reg. §1.121-3(b). [↑](#footnote-ref-2)
3. . Treas. Reg. §1.121-3(c)(2). [↑](#footnote-ref-3)
4. . Treas. Reg. §1.121-3(d)(2). [↑](#footnote-ref-4)
5. . Treas. Reg. §1.121-3(e)(2). [↑](#footnote-ref-5)
6. . Treas. Reg. §1.121-3(e)(1). [↑](#footnote-ref-6)
7. . Treas. Reg. §1.121-3(e)(4), Example 8. [↑](#footnote-ref-7)
8. . IRC Sec. 121(c)(1). [↑](#footnote-ref-8)
9. . IRC Sec. 121(d)(7). [↑](#footnote-ref-9)