**Internal Revenue Service**

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:

Telephone Number:

Refer Reply To:
CC:ITA:B04
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Date:
August 13, 2009

TY:

LEGEND:

| | |
|---|---|
| Taxpayer A | = |
| Taxpayer B | = |
| Area | = |
| Property | = |
| Date Z | = |
| Year 1 | = |
| Year 3 | = |
| Year 5 | = |
| Year 8 | = |
| Year 10 | = |
| Year 12 | = |
| Year 14 | = |
| Year 15 | = |
| Year 17 | = |
| Year 19 | = |
| Year 22 | = |
| Year 25 | = |
| Installation | = |
| Executive | = |

Dear

This responds to your request for a private letter ruling dated May 7, 2009, on whether you may exclude the gain on the sale of your former principal residence under § 121 of the Internal Revenue Code.

FACTS

Taxpayer A and Taxpayer B (Taxpayers) are husband and wife. Taxpayer A serves as a member of the uniformed services of the United States. In March Year 1, while assigned to the Area, Taxpayer A purchased Property. Except as indicated below, Taxpayers used Property as their principal residence when Taxpayer A was assigned to the Area. During periods that Taxpayer A was assigned outside the Area (more than 50 miles from Property) as a member of the uniformed services, Taxpayers rented Property to tenants.

The periods when Taxpayer occupied Property as their principal residence and the periods when Taxpayers did not occupy (and rented) Property are listed below:

Period 1: March Year 1 to April Year 3 – Taxpayers occupied Property as principal residence.

Period 2: April Year 3 to August Year 5 – Taxpayers rented Property when assigned outside of the Area.

Period 3: August Year 5 to December Year 8 – Taxpayers occupied Property as principal residence.

Period 4: December Year 8 to May Year 10 –Taxpayers rented Property when assigned outside of the Area.

Period 5: May Year 10 to June Year 12 –Taxpayers occupied Property as principal residence.

Period 6: June Year 12 to October Year 15 – Taxpayers rented Property when assigned outside of the Area.

Period 7: October Year 15 to January Year 17 –Taxpayers rented property when assigned to Area and voluntarily lived in government quarters.

Period 8: January Year 17 to October Year 19 – Taxpayers rented Property when assigned outside of the Area.

Period 9: October Year 19 through August Year 22 –Taxpayers rented Property when assigned to Area and under orders to live in government quarters.

Period 10: September Year 22 to Date Z Year 25 –Taxpayers rented Property when assigned outside of the Area.

As indicated above, Taxpayers never occupied Property as their principal residence after June Year 12 (Period 5). Also, during Period 7, Taxpayer A was assigned to the Area and lived in government quarters although not under orders to do so. Also, during

Period 9, Taxpayer A was assigned to the Area and was under orders to live in government quarters.

Taxpayer A represents that he expected to retire in Year 25 after completing his career with the uniformed services and that Taxpayers intended to occupy Property as their principal residence after retirement. However, in Year 25, Taxpayer A received an assignment from Executive. As part of this assignment, Taxpayer A was under orders to live in government quarters. Taxpayers sold Property on Date Z Year 25.

LAW

Section 121(a) provides that gain from the sale or exchange of property is not included in gross income if, during the 5-year period ending on the date of the sale or exchange, the taxpayer has owned and used the property as the taxpayer's principal residence for periods aggregating 2 years or more.

Section 121(b)(2) generally provides that the amount of gain excluded from gross income shall not exceed $ 500,000 for married taxpayers who file a joint return.

Section 1.121-2(a)(3)(i) of the Income Tax Regulations provides that a husband and wife who make a joint return for the year of the sale or exchange of a principal residence may exclude up to $500,000 of gain if (1) either spouse meets the 2-year ownership requirements; (2) both spouses meet the 2-year use requirements; and (3) neither spouse excluded gain from a prior sale or exchange of property within the last 2 years.

Section 121(c) provides for a reduced maximum exclusion for a taxpayer that fails to satisfy the ownership and use requirements if the primary reason for the sale is a change in place of employment, health, or the occurrence of unforeseen circumstances.

Section 121(d)(6) provides that the exclusion does not apply to the gain from the sale of any property for the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, for the property.

Section 121(d)(9) provides, in part, that at the election of a taxpayer who is a member of the uniformed services, the running of the five-year period is suspended during any period (up to 10 years) that the taxpayer is serving on qualified official extended duty. Section 121(d)(9)(C)(1) defines "qualified official extended duty" as any extended duty while serving at a duty station at least 50 miles from the property, or while residing in government quarters pursuant to government orders.

ANALYSIS

To qualify for the exclusion under § 121(a), Taxpayers must own and use Property as their principal residence for periods aggregating to at least two years of the five year period ending with the date of sale of that property (ownership and use requirements). Taxpayer A owned Property from March Year 1 to Date Z Year 25 and satisfies the ownership requirements of § 121(a) and § 1.121-2(a)(3)(i).
In determining the five year use period, Taxpayers can elect under § 121(d)(9) to suspend (i.e., toll) the five-year period for up to ten years (120 months) while Taxpayer A was serving on qualified official extended duty at least 50 miles from Property or under orders to live in government quarters. Taxpayers satisfy this requirement from January Year 17 to Date Z Year 25 (102 months) and from April Year 14 to October Year 15 (18 months). However, Taxpayers do not satisfy this requirement from October Year 15 to January Year 17, because Taxpayers resided in the Area and chose to live in government quarters.

Applying § 121(d)(9), the relevant five-year (60-month) period is from October Year 15 to January Year 17 (15 months), plus the time beginning from July Year 10 to April Year 14 (45 months). During this period, Taxpayers lived in the property only from July Year 10 to June Year 12 (23 months). Therefore, Taxpayers do not meet the use requirements of § 121(a), as extended by §121(d)(9). However, § 121(c) allows a taxpayer who fails to meet the ownership and use requirements of § 121(a) to qualify for a reduced maximum exclusion if the sale was the result of a change in the place of employment or the occurrence of other unforeseen circumstances.

Section 1.121-3(c) of the regulations provides a safe harbor that deems that the sale occurs by reason of a change in place of employment if the change occurs while the taxpayer is using the property as a principal residence and the taxpayer’s new place of employment is at least fifty (50) miles farther from the residence sold than the former place of employment. The regulation provides that if a safe harbor for change in place of employment does not apply, a sale or exchange is by reason of change in place of employment only if the primary reason for the sale is a change in the place of employment depending upon all the facts and circumstances. The regulations further provide that 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; and

(3) 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.

Based on all the facts and circumstances, the primary reason for the sale was Taxpayer A's unanticipated assignment that was a change in the place of employment. This was also an unforeseen circumstance. First, in Spring Year 25, Taxpayer A expected to retire after completing his assignment at Installation and Taxpayers intended to return to the Area and live in Property as their principal residence after Taxpayer A retired. The dates between learning of the change in employment and the sale of Property are proximate in time. Next, pursuant to the assignment Taxpayer A was under orders to live in government quarters, and Taxpayers could not live at Property. Accordingly, the suitability of Property materially changed after the unanticipated assignment. Finally, Taxpayers could not have anticipated the assignment at the end of Taxpayer A's career when Taxpayer A purchased Property.

CONCLUSIONS

Taxpayers are entitled to a reduced maximum exclusion under § 121(c). However, the exclusion under § 121 does not apply to any gain from the sale of Property for the portion of the depreciation adjustments (as defined in §1250(b)(3) attributable to Property for periods after May 6, 1997. See § 121(d)(6) of the Code and § 1.121-1(d) of the regulations.

CAVEATS:

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative(s).

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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,

Donna Welsh
Senior Technician Reviewer, Branch 4
(Income Tax & Accounting)

Enclosure (1)

cc: