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Reg. Section 1.121-1(c)(4), Example Five

Exclusion of gain from sale or exchange of a principal residence.

(a) In general. Section 121 provides that, under certain circumstances, gross income does not include gain realized on the sale or exchange of property that was owned and used by a taxpayer as the taxpayer's principal residence. Subject to the other provisions of section 121, a taxpayer may exclude gain only if, during the 5-year period ending on the date of the sale or exchange, the taxpayer owned and used the property as the taxpayer's principal residence for periods aggregating 2 years or more.

(b) Residence -- (1) In general. Whether property is used by the taxpayer as the taxpayer's residence depends upon all the facts and circumstances. A property used by the taxpayer as the taxpayer's residence may include a houseboat, a house trailer, or the house or apartment that the taxpayer is entitled to occupy as a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b)(1) and (2)). Property used by the taxpayer as the taxpayer's residence does not include personal property that is not a fixture under local law.

(2) Principal residence. In the case of a taxpayer using more than one property as a residence, whether property is used by the taxpayer as the taxpayer's principal residence depends upon all the facts and circumstances. If a taxpayer alternates between 2 properties, using each as a residence for successive periods of time, the property that the taxpayer uses a majority of the time during the year ordinarily will be considered the taxpayer's principal residence. In addition to the taxpayer's use of the property, relevant factors in determining a taxpayer's principal residence, include, but are not limited to --

- (i) The taxpayer's place of employment;
- (ii) The principal place of abode of the taxpayer's family members;
- (iii) The address listed on the taxpayer's federal and state tax returns, driver's license, automobile registration, and voter registration card;
- (iv) The taxpayer's mailing address for bills and correspondence;
- (v) The location of the taxpayer's banks; and
- (vi) The location of religious organizations and recreational clubs with which the taxpayer is affiliated.

(3) Vacant land -- (i) In general. The sale or exchange of vacant land is not a sale or exchange of the taxpayer's principal residence unless --

(A) The vacant land is adjacent to land containing the dwelling unit of the taxpayer's principal residence;

(B) The taxpayer owned and used the vacant land as part of the taxpayer's principal residence;

(C) The taxpayer sells or exchanges the dwelling unit in a sale or exchange that meets the requirements of section 121 within 2 years before or 2 years after the date of the sale or exchange of the vacant land; and

(D) The requirements of section 121 have otherwise been met with respect to the vacant land.

(ii) Limitations -- (A) Maximum limitation amount. For purposes of section 121(b)(1) and (2) (relating to the maximum limitation amount of the section 121 [26 USCS § 121] exclusion), the sale or exchange of the dwelling unit and the vacant land are treated as one sale or exchange. Therefore, only one maximum limitation amount of \$ 250,000 (\$ 500,000 for certain joint returns) applies to the combined sales or exchanges of vacant land and the dwelling unit. In applying the maximum limitation amount to sales or exchanges that occur in different taxable years, gain from the sale or exchange of the dwelling unit, up to the maximum limitation amount under section 121(b)(1) or (2), is excluded first and each spouse is treated as excluding one-half of the gain from a sale or exchange to which section 121(b)(2)(A) and § 1.121-2(a)(3)(i) (relating to the limitation for certain joint returns) apply.

(B) Sale or exchange of more than one principal residence in 2-year period. If a dwelling unit and vacant land are sold or exchanged in separate transactions that qualify for the section 121 exclusion under this paragraph (b)(3), each of the transactions is disregarded in applying section 121(b)(3) (restricting the application of section 121 to only 1 sale or exchange every 2 years) to the other transactions but is taken into account as a sale or exchange of a principal residence on the date of the transaction in applying section 121(b)(3) to that transaction and the sale or exchange of any other principal residence.

(C) Sale or exchange of vacant land before dwelling unit. If the sale or exchange of the dwelling unit occurs in a later taxable year than the sale or exchange of the vacant land and after the date prescribed by law (including extensions) for the filing of the return for the taxable year of the sale or exchange of the vacant land, any gain from the sale or exchange of the vacant land must be treated as taxable on the taxpayer's return for the taxable year of the sale or exchange of the vacant land. If the taxpayer has reported gain from the sale or exchange of the vacant land as taxable, after satisfying the requirements of this paragraph (b)(3) the taxpayer may claim the section 121 exclusion with regard to the sale or exchange of the vacant land (for any period for which the period of limitation under section 6511 has not expired) by filing an amended return.

(4) Examples. The provisions of this paragraph (b) are illustrated by the following examples:

Example 1. Taxpayer A owns 2 residences, one in New York and one in Florida. From 1999 through 2004, he lives in the New York residence for 7 months and the Florida residence for 5 months of each year. In the absence of facts and circumstances indicating otherwise, the New York residence is A's principal residence. A would be eligible for the section 121 exclusion of gain from the sale or exchange of the New York residence, but not the Florida residence.

Example 2. Taxpayer B owns 2 residences, one in Virginia and one in Maine. During 1999 and 2000, she lives in the Virginia residence. During 2001 and 2002, she lives in the Maine residence. During 2003, she lives in the Virginia residence. B's principal residence during 1999, 2000, and 2003 is the Virginia residence. B's principal residence during 2001 and 2002 is the Maine residence. B would be eligible for the 121 exclusion of gain from the sale or exchange of either residence (but not both) during 2003.

Example 3. In 1991 Taxpayer C buys property consisting of a house and 10 acres that she uses as her principal residence. In May 2005 C sells 8 acres of the land and realizes a gain of \$ 110,000. C does not sell the dwelling unit before the due date for filing C's 2005 return, therefore

C is not eligible to exclude the \$ 110,000 of gain. In March 2007 C sells the house and remaining 2 acres realizing a gain of \$ 180,000 from the sale of the house. C may exclude the \$ 180,000 of gain. Because the sale of the 8 acres occurred within 2 years from the date of the sale of the dwelling unit, the sale of the 8 acres is treated as a sale of the taxpayer's principal residence under paragraph (b)(3) of this section. C may file an amended return for 2005 to claim an exclusion for \$ 70,000 (\$ 250,000-\$ 180,000 gain previously excluded) of the \$ 110,000 gain from the sale of the 8 acres.

Example 4. In 1998 Taxpayer D buys a house and 1 acre that he uses as his principal residence. In 1999 D buys 29 acres adjacent to his house and uses the vacant land as part of his principal residence. In 2003 D sells the house and 1 acre and the 29 acres in 2 separate transactions. D sells the house and 1 acre at a loss of \$ 25,000. D realizes \$ 270,000 of gain from the sale of the 29 acres. D may exclude the \$ 245,000 gain from the 2 sales.

(c) Ownership and use requirements -- (1) In general. The requirements of ownership and use for periods aggregating 2 years or more may be satisfied by establishing ownership and use for 24 full months or for 730 days (365 x 2). The requirements of ownership and use may be satisfied during nonconcurrent periods if both the ownership and use tests are met during the 5-year period ending on the date of the sale or exchange.

(2) Use. (i) In establishing whether a taxpayer has satisfied the 2-year use requirement, occupancy of the residence is required. However, short temporary absences, such as for vacation or other seasonal absence (although accompanied with rental of the residence), are counted as periods of use.

(ii) Determination of use during periods of out-of-residence care. If a taxpayer has become physically or mentally incapable of self-care and the taxpayer sells or exchanges property that the taxpayer owned and used as the taxpayer's principal residence for periods aggregating at least 1 year during the 5-year period preceding the sale or exchange, the taxpayer is treated as using the property as the taxpayer's principal residence for any period of time during the 5-year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

(3) Ownership -- (i) Trusts. If a residence is owned by a trust, for the period that a taxpayer is treated under sections 671 through 679 (relating to the treatment of grantors and others as substantial owners) as the owner of the trust or the portion of the trust that includes the residence, the taxpayer will be treated as owning the residence for purposes of satisfying the 2-year ownership requirement of section 121, and the sale or exchange by the trust will be treated as if made by the taxpayer.

(ii) Certain single owner entities. If a residence is owned by an eligible entity (within the meaning of § 301.7701-3(a) of this chapter) that has a single owner and is disregarded for federal tax purposes as an entity separate from its owner under § 301.7701-3 of this chapter, the owner will be treated as owning the residence for purposes of satisfying the 2-year ownership requirement of section 121, and the sale or exchange by the entity will be treated as if made by the owner.

(4) Examples. The provisions of this paragraph (c) are illustrated by the following examples. The examples assume that § 1.121-3 (relating to the reduced maximum exclusion) does not apply to the sale of the property. The examples are as follows:


Example 1. Taxpayer A has owned and used his house as his principal residence since 1986. On January 31, 1998, A moves to another state. A rents his house to tenants from that date until

April 18, 2000, when he sells it. A is eligible for the section 121 exclusion because he has owned and used the house as his principal residence for at least 2 of the 5 years preceding the sale.

Example 2. Taxpayer B owns and uses a house as her principal residence from 1986 to the end of 1997. On January 4, 1998, B moves to another state and ceases to use the house. B's son moves into the house in March 1999 and uses the residence until it is sold on July 1, 2001. B may not exclude gain from the sale under section 121 because she did not use the property as her principal residence for at least 2 years out of the 5 years preceding the sale.

Example 3. Taxpayer C lives in a townhouse that he rents from 1993 through 1996. On January 18, 1997, he purchases the townhouse. On February 1, 1998, C moves into his daughter's home. On May 25, 2000, while still living in his daughter's home, C sells his townhouse. The section 121 exclusion will apply to gain from the sale because C owned the townhouse for at least 2 years out of the 5 years preceding the sale (from January 19, 1997 until May 25, 2000) and he used the townhouse as his principal residence for at least 2 years during the 5-year period preceding the sale (from May 25, 1995 until February 1, 1998).

Example 4. Taxpayer D, a college professor, purchases and moves into a house on May 1, 1997. He uses the house as his principal residence continuously until September 1, 1998, when he goes abroad for a 1-year sabbatical leave. On October 1, 1999, 1 month after returning from the leave, D sells the house. Because his leave is not considered to be a short temporary absence under paragraph (c)(2) of this section, the period of the sabbatical leave may not be included in determining whether D used the house for periods aggregating 2 years during the 5-year period ending on the date of the sale. Consequently, D is not entitled to exclude gain under section 121 because he did not use the residence for the requisite period.



Example 5. Taxpayer E purchases a house on February 1, 1998, that he uses as his principal residence. During 1998 and 1999, E leaves his residence for a 2-month summer vacation. E sells the house on March 1, 2000. Although, in the 5-year period preceding the date of sale, the total time E used his residence is less than 2 years (21 months), the section 121 exclusion will apply to gain from the sale of the residence because, under paragraph (c)(2) of this section, the 2-month vacations are short temporary absences and are counted as periods of use in determining whether E used the residence for the requisite period.

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