

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:
, ID No.

Telephone Number:

Refer Reply To:
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PLR-126940-05

Date:
December 19, 2005

Legend

Taxpayer A =
Residence =

Year 1 =
Date 1 =
Date 2 =
Date 3 =
State =

Dear

This letter is in response to a request for a ruling that you and your spouse (hereinafter "you") are entitled to the reduced maximum exclusion on gain from the sale of Residence under § 121(c) of the Internal Revenue Code.

FACTS

You purchased Residence (which contains three bedrooms) on Date 1 and immediately used it as your principal residence. You occupied one of the bedrooms and your three sons occupied the remaining two bedrooms.

After moving into Residence, you decided that you wanted to adopt an orphan girl from a foreign country. You contacted various agencies about adopting a foreign child. You learned that under State law you could not adopt a girl unless she had a separate sizable bedroom. Thus, you could not pass the home study, which is the first step toward adoption, at Residence because you could not provide a girl with a separate bedroom.

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You were also informed that once the home study begins, all information must be consistent throughout the entire adoption process, or the home study inspections and reviews would have to be completely redone. Further, Taxpayer A is currently in the military and is scheduled to be transferred to a new post of duty in the summer or the fall of Year 1. It is important that you start and complete the process of adoption so that the adoption process is completed before the transfer. If the adoption is not completed before the transfer, the entire adoption process must start over. Thus, you decided to rent a larger home with an additional room in which a girl could have her own bedroom. You used this rented residence to provide the required information for the home study concerning the home in which an adopted girl would live.

During Date 2, you received the initial paperwork for the home study. The instructions stated that the entire application must be completed, along with all medical forms and home inspections, before submitting the application with associated fees.

Prior to moving out of Residence, you took many steps required to adopt a girl. For example, you obtained birth, marriage, divorce, and driving records, and letters of recommendation, ordered and obtained required medical tests for you and your sons, submitted Form I-600A, Application for Advance Processing of Orphan Petition to the Immigration and Naturalization Service, and arranged for inspections of the rented residence. You paid substantial amounts in fees for these and other services in connection with the adoption process before moving out of Residence. On Date 3, you sold Residence, which you had used and owned as your principal residence for less than two years. The day before the sale, you moved into the rented residence.

LAW AND ANALYSIS

Section 121(a) provides that a taxpayer's gross income will not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two year or more. The full exclusion is available only once every two years. Section 121(b)(3).

Section 121(b) provides that the maximum exclusion amount is \$500,000 if (1) a husband and wife file a joint return for the taxable 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 § 121 exclusion during the last two years.

Section 121(c) 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.

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Section 1.121-3(e)(1) of the 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 could not reasonably have anticipated before purchasing and occupying the residence.

Section 1.121-3(g) 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).

CONCLUSIONS

Based on all of the facts and circumstances as represented and the authority set forth above, we conclude that your primary reason for the sale of Residence was an unforeseen circumstance. Accordingly, we conclude that you are entitled to exclude gain up to the reduced maximum exclusion amount under § 121(c).

Except as specifically ruled upon in the preceding paragraph, 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 you used Residence as your principal residence.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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.

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter

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showing the deletions proposed to be made when it is disclosed under § 6110.

Sincerely,

Michael J. Montemurro
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)