Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201944006**
Release Date: 11/1/2019

Index Number: 121.00-00, 1031.00-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B04
PLR-103273-19

Date:
July 31, 2019

Taxpayer 1 =
EIN: =

Property 1 =

Date 1 =

Amount 1 =

Taxpayer 2 =
EIN: =

Date 2 =

Year 1 =

Date 3 =

Property 2 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Amount 2 =

Year 2 =

Date 9 =

Amount 3 =

Date 10 =

Property 3 =

Amount 4 =

Dear :

This letter responds to your private letter ruling request, dated February 14, 2019, and supplemental information, dated May 29, 2019, regarding a disposition of real property. You have requested rulings on the application of § 121 of the Internal Revenue Code to the disposition, whether § 121 and § 1031 may be applied to the same transfer of property, and whether the property disposed of is held for investment for purposes of deferring the remaining gain under § 1031.

Facts

Taxpayer 1 purchased Property 1 as a principal residence on Date 1 for Amount 1. Taxpayer 1 and Taxpayer 2 (collectively "Taxpayers") were married on Date 2. Taxpayers used Property 1 as their principal residence from Year 1 until Date 3. Taxpayers moved to Property 2, their current principal residence, around Date 4.

From around Date 5 until Date 8 (rental period), Taxpayers rented Property 1 to tenants or listed the property for rent. From Date 6 to Date 7, Taxpayers rented Property 1 to full-time tenants. Otherwise, Taxpayers engaged in short-term rentals of Property 1 during the rental period until Date 8 when Property 1 was destroyed in a fire.

As a result of the destruction to the dwelling unit on Property 1, Taxpayers received insurance proceeds totaling Amount 2 in the year of the destruction, Year 2. On Date 9, Taxpayer 1 sold the land on which the dwelling unit was located for Amount 3. On Date 10, Taxpayers acquired Property 3 for Amount 4.

Applicable Law

Section 121(a) provides that the 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 the property (the ownership requirement) and used the property as the taxpayer's principal residence (the use requirement) for 2 years or more. Under § 121(b), the amount of gain excluded from gross income with respect to any sale or exchange cannot exceed the maximum limitation amount, which is $250,000, or $500,000 in the case of a husband and wife who file a joint return for the taxable year of the sale or exchange. For spouses to satisfy the requirements of § 121, either spouse must meet the ownership requirement of § 121(a) with respect to such property and both spouses must meet the use requirement of § 121(a) with respect to such property. In addition, neither spouse may be ineligible for the exclusion under § 121(a) with respect to such property due to the limitation of only one sale or exchange every two years. See § 121(b)(3).

Section 1.121-1(b)(3)(i) of the Income Tax Regulations addresses whether the sale or exchange of vacant land qualifies as a sale or exchange of a taxpayer's principal residence. Under § 1.121-1(b)(3)(i), gain on the sale of vacant land may be excluded under § 121, if: (1) the vacant land is adjacent to the land containing the dwelling unit of the taxpayer's principal residence; (2) the taxpayer owned and used the vacant land as part of the taxpayer's principal residence; (3) the taxpayer sold or exchanged the dwelling unit in a sale or exchange that meets the requirements of § 121 within 2 years before or 2 years after the date of the sale or exchange of the vacant land; and (4) the taxpayer meets the other requirements of § 121 with respect to the vacant land.

Section 1.121-1(b)(3)(ii)(A) further provides that the sale or exchange of the dwelling unit and the vacant land are treated as one sale or exchange and the maximum limitation amount applies to the combined sales of the dwelling unit and vacant land. 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 is excluded first.

For purposes of determining the amount of gain from the sale or exchange of property, § 1001(a) provides that gain from the sale or other disposition of property is the excess of the amount realized on the disposition over the adjusted basis provided in § 1011. Under § 1001(c), the entire amount of the gain or loss must be recognized in the year of the sale or exchange, except as otherwise provided in Subtitle A of the Code.

Section 1031(a) provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment (the relinquished property) if the property is exchanged solely for property of like kind (the replacement property) that is to be held either for productive use in a trade or business or for investment.

The issue of whether § 121 and § 1031 may apply to the same transfer of property was addressed in Rev. Proc. 2005-14, 2005-1 C.B. 528. The revenue procedure provides that a transfer of property qualifying for the § 121 exclusion may also qualify for nonrecognition under § 1031, provided that the requirements of § 1031(a) are met with respect to the transfer.

Analysis

Section 1.121-1(b)(3)(i) addresses when gain from a sale of land is excluded under § 121. Although Taxpayers sale of land is not a sale of vacant land as described in § 1.121-1(b)(3) (§ 1.121-1(b)(3) addresses the sale of property adjacent to the dwelling unit whereas the land sold by Taxpayers is the actual property on which the dwelling unit was located), it is reasonable to apply those same requirements to a sale of vacant land on which the dwelling unit was actually located. Here, Taxpayers meet the requirements in § 1.121-1(b)(3)(i) on the sale of their land and gain from the sale is excluded as provided in § 121. The destruction of the dwelling unit and subsequent receipt of insurance proceeds in the taxable year before the land sale qualifies as a sale or exchange of the dwelling unit within 2 years of the land sale as described in § 1.121-1(b)(3). In addition, Taxpayers meet the other requirements of § 121 with respect to the land. Taxpayer 1 purchased Property 1 on Date 1 and owned the underlying land until Date 9. Thus, Taxpayer 1 met the ownership requirement under § 121(b)(2)(A)(i) for the land. Both Taxpayers resided on Property 1 as their principal residence from Year 1 until Date 3. Therefore both spouses met the use requirement of § 121(b)(2)(A)(ii) for the land. Finally, Taxpayers assert that neither spouse is ineligible for the benefits under § 121(a) because neither spouse applied § 121 to a sale within two years of the sale of Property 1. The sale or exchange of the dwelling unit and the land, although occurring in different taxable years, are treated as one sale or exchange for purposes of § 121(b)(3). See § 1.121-1(b)(3)(B).

In addition, under § 1.121-1(b)(3)(ii)(A), in applying the maximum limitation amount under § 121 to sales or exchanges of a dwelling unit in one year and land that qualifies for the exclusion under § 121 in a subsequent taxable year, gain from the sale or exchange of the dwelling unit is excluded first. Gain on the sale of the land is then excluded only to the extent of the maximum limitation amount applicable to the taxpayer, minus the gain excluded on the sale of the dwelling unit.

Here, Taxpayers sold the dwelling unit on Property 1 in Year 2 and sold the land on which the dwelling unit was located before its destruction on Date 9. Therefore, the

gain excluded under § 121 on the sale of the land is the difference between the maximum limitation amount applicable to Taxpayers and the gain excluded under § 121 in the Year 2 sale of the dwelling unit.

Finally, Taxpayers represent that they held Property 1 as investment property from around Date 5 until Date 9. Therefore, Taxpayers held Property 1 for investment, as described in § 1031(a), prior to its transfer on Date 9. Under Rev. Proc. 2005-14, a transfer of property qualifying for the § 121 exclusion may also qualify for nonrecognition under § 1031, provided all the requirements of § 1031are met with respect to the transfer. The fact that Taxpayers exclude gain under § 121 on the sale or exchange of Property 1, does not preclude them from deferring all or a portion of the remainder of the gain, if any, under § 1031.

Based on the facts and representations submitted by the Taxpayers, we rule as follows:

(1) Section 121 applies to the sale of the land. The gain excluded under § 121 on the sale of the land is the difference between the maximum limitation amount applicable to Taxpayers and the gain excluded under § 121 in the Year 2 sale of the dwelling unit.
(2) The fact that Taxpayers exclude gain under § 121 on the sale or exchange of Property 1 does not preclude them from deferring all or a portion of the remainder of the gain, if any, under § 1031.
(3) Taxpayers held Property 1 for investment, as described in § 1031(a), prior to its transfer on Date 9.

Pursuant to section 7.06 of Rev. Proc. 2019-1, 2019-1 I.R.B 1, Taxpayers must attach a copy of this letter ruling to any Federal income tax return to which it is relevant. If Taxpayers file their returns electronically, they may satisfy this requirement by attaching a statement to the return that provides the date and control number of this letter ruling.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we express no opinion on whether the transfer of Property 1 and the acquisition of Property 3 meets all the requirements for non-recognition of gain or loss under § 1031.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. However, this office has not verified any of the material submitted in support of the request for these rulings, and therefore it is subject to verification on examination.

This ruling is directed only to the Taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the provisions of a power of attorney currently on file, we are sending a copy of this letter to the Taxpayers' authorized representative,

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If you have any questions concerning this matter, please contact the individual whose name and telephone number appear at the beginning of the letter.

Sincerely,

Stephen J. Toomey
Senior Counsel
Office of Associate Chief Counsel
(Income Tax & Accounting)