Reduced Maximum Exclusion of Gain From Sale or Exchange of Principal Residence for Taxpayers Affected by the September 11, 2001, Terrorist Attacks

Notice 2002–60

This notice informs taxpayers affected by the September 11, 2001, terrorist attacks of the circumstances under which they may qualify for the reduced maximum exclusion of gain on the sale or exchange of a principal residence provided by § 121(c) of the Internal Revenue Code for taxpayers who have not owned and used their principal residence for 2 of the 5 years preceding the sale or exchange or who have applied § 121 to the sale or exchange of a principal residence in the last 2 years. This treatment is consistent with the approach the Service intends to take in final regulations under § 121.

Reduced Maximum Exclusion by Reason of Unforeseen Circumstances

Section 121 allows a taxpayer to exclude up to $250,000 ($500,000 for certain joint returns) of gain realized on the sale or exchange of the taxpayer's principal residence. For the maximum exclusion to apply, § 121(b) requires the taxpayer to have both owned and used the property as the taxpayer's principal residence for at least 2 years during the 5-year period ending on the date of the sale or exchange. Section 121(b)(3) allows the taxpayer to apply the maximum exclusion to only one sale or exchange in every two-year period ending on the date of the sale or exchange. Section 121(c) provides that a taxpayer who fails to meet any of these conditions by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances, is entitled to an exclusion in a reduced maximum amount.

On October 10, 2000, a notice of proposed rulemaking (REG–105235–99, 2000–2 C.B. 447) under § 121 was published in the **Federal Register** (65 FR 60136). The proposed regulations requested comments regarding what circumstances should qualify as unforeseen for purposes of the reduced maximum exclusion. Comments suggested that, among others, the death of the taxpayer's spouse, man-made disasters, and acts of war should be considered unforeseen circumstances. The final regulations will adopt these comments. The final regulations will also provide the Commissioner with the discretion to determine that other circumstances qualify as unforeseen for purposes of the reduced maximum exclusion.

Recently, the Service has been asked whether taxpayers affected by the September 11, 2001, terrorist attacks are entitled to exclude the gain from the sale of a principal residence in a reduced maximum amount by reason of unforeseen circumstances. In response, the Commissioner has determined that taxpayers affected by the September 11, 2001, terrorist attacks are entitled to the reduced maximum exclusion. Therefore, a taxpayer may claim a reduced maximum exclusion of gain on a sale or exchange of the taxpayer's principal residence by reason of unforeseen circumstances if the taxpayer sells or exchanges the residence as a result of being affected by the attacks in one or more of the following ways:

(1) A qualified individual (as defined below) was killed,

(2) The taxpayer's principal residence was damaged (without regard to whether, under the taxpayer's circumstances, the taxpayer is entitled to a casualty loss deduction under § 165(h)),

(3) A qualified individual (as defined below) lost employment and became eligible for unemployment compensation (as defined in § 85(b)), or

(4) A qualified individual (as defined below) experienced a change in employment or self-employment that resulted in the taxpayer's inability to pay reasonable basic living expenses for the taxpayer's household (including amounts for food, clothing, housing and related expenses, medical expenses, taxes, transportation, court-ordered payments, and expenses reasonably necessary to production of income, but not for the maintenance of an affluent or luxurious standard of living).

For purposes of the preceding sentence, the term "qualified individual" means, as of September 11, 2001, (1) the taxpayer, (2) the taxpayer's spouse, (3) a co-owner of the residence, or (4) a person whose principal place of abode is in the same household as the taxpayer.

Taxpayers who qualify to claim a reduced maximum exclusion under this notice and have filed their returns for taxable year 2001 may file amended returns to claim the exclusion.

Computation of the Reduced Maximum Exclusion

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).

DRAFTING INFORMATION

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