Department of the Treasury | **Internal Revenue Service** | **Office of Chief Counsel**

Notice

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UIL 121.00-00

August 10, 1999

Subject: CHANGE IN LITIGATING POSITION **Cancellation Date:** August 10, 2000

The purpose of this Notice is to announce a change in the Service's litigating position regarding whether a bankruptcy estate may take advantage of the section 121 exclusion of gain on the sale of a personal residence. The Service now agrees that the bankruptcy estate may use the section 121 exclusion.

The Taxpayer Relief Act of 1997 amended section 121 to provide that the gain from a sale or exchange of property is excluded from gross income up to the amount of $250,000 ($500,000 in the case of certain joint returns) if during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more. There is no age restriction and the exclusion is not limited to one sale or exchange during the taxpayer's lifetime. The Service has previously taken the position that a bankruptcy estate may not use the section 121 exclusion because it is personal to the debtor. The Service unsuccessfully advocated this position. See In re Popa, 218 B.R. 420 (Bank. N.D.Ill. 1998); United States v. Arkison (In re Kerr) (W.D. Wash. 1999); United States v. Arkison (In re Sevy) (W.D. Wash. 1999); United States v. Arkison (In re Cooper) (W.D. Wash. 1999); and Internal Revenue Service v. Waldschmidt (In re Bradley) (M.D. Tenn. 1999), aff'g 222 B.R. 313 (Bankr. M.D. Tenn. 1998). But see In re Winch, 226 B.R. 591 (Bankr. S.D. Ohio 1998).

The courts, in ruling against the Service on this matter, found authority for the bankruptcy estate's use of the section 121 exclusion in several subsections of section 1398. Section 1398 treats a bankruptcy estate of an individual created under chapter 7 or 11 of Title 11 of the United States Code as a separate taxable entity. Section 1398(c) provides that the taxable income of the bankruptcy estate shall be computed in the same manner as for an individual. Subsection (f)(1) provides that the transfer (other than by sale or exchange) of an asset from the debtor to the estate shall not be treated as a disposition, and the estate shall be treated as the debtor would be with respect to such asset. Subsection (g)(6) provides that, in the case of any asset acquired (other than by sale or exchange) by the estate from the debtor, the estate

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shall succeed to and take into account the basis, holding period, and character the asset had in the hands of the debtor.

In the Service's view, sections 1398(c)(1), (f)(1), and (g)(6), when read together, support the bankruptcy estate's claim to the section 121 exclusion. Accordingly, attorneys should no longer advocate the position that bankruptcy estates may not use the section 121 exclusion if the debtor would otherwise meet the requirements. In pending cases where the position has already been adopted, the Department of Justice should be advised, via letter, to abandon the position.

If you have any questions concerning this memorandum, please contact Mike Nixon at (202) 622-7920.

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for JUDITH C. DUNN
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