

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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Refer Reply To:
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Date: 6-26-01

Dear Ms. [REDACTED],

This responds to your April 25, 2001 letter regarding whether gain from the sale of a portion of your residential property without the sale of the house may be excluded from your gross income under section 121 of the Internal Revenue Code (the Code).

We are happy to provide the following information. As provided in section 2.04 of Revenue Procedure 2001-1, 2001-1 I.R.B. 1, 9, information letters are advisory only and have no binding effect on the Internal Revenue Service.

According to your inquiry, you purchased property consisting of eleven acres and a house and have used this property as your principal residence since 1992. You now intend to sell the property in two separate sales. First, you wish to sell six vacant acres of the original eleven acres. Then, you hope to sell the house and the five remaining acres once you have completed constructing a new residence.

Section 312 of the Taxpayer Relief Act of 1997, 1997-4 (Vol. 1) C.B. 1, 50 (TRA 1997) amended section 121 and repealed section 1034 of the Code. Before its repeal, section 1034 provided that if a taxpayer sold a principal residence and purchased a replacement residence within a period beginning two years before the date of sale and ending two years after the date of sale (the replacement period), the taxpayer recognized gain on the sale or exchange only to the extent that the adjusted sales price of the old residence exceeded the cost of purchasing the new residence. Section 1034 only applies to sales occurring on or before May 6, 1997.

For sales after May 6, 1997, under the general rules of section 121 of the Code, a taxpayer may exclude up to \$250,000 (\$500,000 for certain joint returns) of gain on the sale of property if that property was owned and used as the taxpayer's principal residence for an aggregate period of two years or more during the five-year period ending on the date of the sale.

Generally, the sale of a portion of a taxpayer's residential property without the sale of the house will not qualify as a sale of the taxpayer's residence. This issue is well-settled under case law and revenue rulings applying section 1034 of the Code. See Rev. Rul. 56-420, 1956-2 C.B. 519; Rev. Rul. 83-50, 1983-1 C.B. 41 (disallowed section 1034 nonrecognition where taxpayer sold land on which the principal residence was located, but not the residence itself); O'Barr v. Commissioner, 44 T.C. 501 (1965)(holding "[w]hile a residence can consist of a dwelling house and adjacent land,

the adjacent land alone cannot be considered a residence”); Roy v. Commissioner, T.C. Memo 1995-23; Hale v. Commissioner, T.C. Memo 1982-527. Cases interpreting section 1034 have created an exception to this rule. The sale of vacant land may constitute the taxpayer’s residence for section 1034 purposes if the sale of the vacant land is one of a series of transactions that includes the sale of the house and the series of transactions all occur during the two-year replacement period. See Bogley v. Commissioner, 263 F.2d 746 (1959). The Internal Revenue Service adopted this rationale in Rev. Rul. 76-541, 1976-2 C.B. 246.

The taxpayer in Rev. Rul. 76-541 owned property which consisted of a house situated on ten acres. In 1975 the taxpayer sold the house and the three vacant acres immediately surrounding the house, and later sold another two vacant acres to a different purchaser. In 1976 the taxpayer constructed and inhabited a new house on the remaining five acres. The taxpayer treated the gain from both sales as gain from the sale of the old residence, and sought to rollover this gain under section 1034(a) into the newly constructed house. The revenue ruling treats the sale of the vacant land as a sale of the taxpayer’s residence for purposes of section 1034 because the sale of the vacant land and the sale of the house both occurred during the two-year replacement period. The revenue ruling concludes that the nonrecognition provision of section 1034 applies to the gain realized from both sales.

It is unclear whether a similar exception exists for purposes of section 121. Because section 121 does not have the same statutory framework providing a two-year replacement period as section 1034, perhaps the above case law and Rev. Rul. 76-541 would not apply. On the other hand, because section 1.121-1(c) of the proposed Income Tax Regulations published in the Federal Register on October 10, 2000, 65 Fed. Reg. 60136, proposed to provide in final regulations that occupancy of the residence is required to satisfy the use requirement under section 121, perhaps the exclusion would be available as long as the two-year use of the adjacent vacant land occurred during the two-year occupancy of the residence. Since 1997 when section 121 was amended and section 1034 was repealed, no final regulations, litigation or published guidance has considered whether section 121 applies to a series of transactions involving the separate sales of the taxpayer’s principal residence and adjacent vacant land.

Because there exists no reliable precedent addressing this issue, you may wish to seek a private letter ruling from the Internal Revenue Service. A private letter ruling is a written statement issued to a taxpayer that interprets and applies the tax laws to the taxpayer’s specific set of facts. Once a private letter ruling is issued, a taxpayer ordinarily may rely on its conclusions regarding the tax consequences of the taxpayer’s transactions. You may obtain a private letter ruling by submitting a request accompanied by a user fee in accordance with the procedures in Revenue Procedure 2001-1, 2001-1 I.R.B. 1.

We hope this information has been helpful. If you have additional questions, please contact Sara Shepherd at (202) 622-4960.

Sincerely,

/s/

George Baker
Assistant to the Chief, Branch 5
(Income Tax and Accounting)

Enclosure:
Revenue Procedure 2001-1