

An individual can exclude up to \$250,000 (\$500,000 for certain joint filers) of the gain from the sale of his principal residence if he has owned and used the residence as his principal residence for at least two years out of the five-year period before the sale.

A reduced exclusion is available if the reason for the sale is a change in place of employment, health, or other unforeseen circumstances where the taxpayer fails to meet the two-year ownership and use requirements or has already used the exclusion for a sale of a principal residence in the past two years. If you qualify for the reduced exclusion, the amount of the reduced exclusion equals a fraction of the \$250,000/\$500,000 dollar limitation. The fraction is based on the portion of the two-year period in which the seller/taxpayer satisfies the ownership and use requirements. For example, if you have owned and used your home for one year, a single individual's exclusion would be \$125,000 (\$250,000 for certain joint filers).

In each category that qualifies for the reduced exclusion, IRS has outlined various facts and circumstances (usually referred to as "safe harbors") that permit the taxpayer to qualify for a reduced exclusion. The safe harbors include:

- The "distance safe harbor", which provides that a change in place of employment is considered to be the reason for the sale of the principal residence if the change occurred during the period the seller used the property as his principal residence and the new place of employment is at least 50 miles farther from the home that was sold than the former place of employment was. If the seller didn't have a former place of employment, the distance between the new place of employment and the home sold has to be at least 50 miles.
- The "physician's recommendation safe harbor", which provides that health is considered to be the reason for the sale of the principal residence if a doctor recommends a change of residence to obtain, provide or facilitate the diagnosis, cure, or mitigation of treatment of a disease, illness, or injury of a qualified individual (generally, a member of the taxpayer's immediate family) or to obtain or provide medical or personal care for a qualified person suffering from a disease, illness, or injury. If the sale of a home merely benefits a qualified individual's health or well-being, the sale is not because of health for purposes of the exclusion.
- The "unforeseen circumstances" safe harbor. IRS considers unforeseen circumstances to be the reason for the sale of a home if any of the following events occurred while the seller owned and used the home as his principal residence: an involuntary conversion of the home, certain natural or man-made disasters or acts of war or terrorist attacks resulting in a casualty to the home (whether or not the loss is deductible), death of a qualified individual, unemployment of a qualified individual if that individual is eligible for unemployment compensation), change of employment or self-employment status resulting in a qualified individual's inability to pay reasonable basic living expenses for his household, divorce or legal separation of a qualified individual, multiple births from the same pregnancy, and events identified by IRS as unforeseen circumstances (for example, the September 11 terrorist attacks). For purposes of these safe harbors, a qualified individual includes the owner of the principal residence (the taxpayer), his spouse, a co-owner of the home, or a person whose principal residence is the same as the taxpayer's principal residence.