BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 21705
[REDACTED],	)	
	)	DECISION
Petitioner.	)	
	)	

[Redacted][Redacted] (petitioner) protests the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated January 23, 2009, asserting additional liability for Idaho income tax, penalty, and interest in the total amount of $31,348 for taxable year 2005.

There are two issues to be addressed, both from the disposition of a residence in [Redacted], California. From the information in the file, it appears that the petitioner moved out of the property in question in 1992. The petitioner's then wife lived in the property for some time after 1992, possibly until its sale on May 17, 2005. In October 2000, the petitioner moved from California to Idaho. In April 2001, he purchased a home in Idaho in which he lived. The Idaho property was sold on January 20, 2006. The petitioner's portion of the gain from the sale of the [Redacted] property was reported to be $347,702. Of this amount, he excluded $250,000 as an exclusion pursuant to Internal Revenue Code § 121. He claimed an Idaho capital gain deduction in the amount of $62,221 (60% of $103,702[1]) with regard to the portion that he deemed to be taxable.

The auditor disallowed the Idaho capital gain deduction claimed and disallowed the exclusion in the amount of $250,000. He also allowed the petitioner a deduction for a net operating loss reported on the petitioner's 2004 Idaho income tax return, but not claimed on his 2005 Idaho income tax return.

[1] The difference between the gain reported ($347,702 – $250,000 = $97,702) and this amount is not explained.

The authority for the Idaho capital gain deduction is set out in Idaho Code § 63-3022H which states, in part:

> Deduction of capital gains. -- (1) If an individual taxpayer reports capital gain net income in determining taxable income, eighty percent (80%) in taxable year 2001 and sixty percent (60%) in taxable years thereafter of the capital gain net income from the sale or exchange of qualified property shall be a deduction in determining Idaho taxable income.
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> (2) The deduction provided in this section is limited to the amount of the capital gain net income from all property included in taxable income. Gains treated as ordinary income by the Internal Revenue Code do not qualify for the deduction allowed in this section. The deduction otherwise allowable under this section shall be reduced by the amount of any federal capital gains deduction relating to such property, but not below zero.
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> (3) As used in this section "qualified property" means the following property having an Idaho situs at the time of sale:
>
> (a) Real property held at least twelve (12) months;

The auditor disallowed the capital gains deduction due to the property being located outside Idaho. The petitioner has not shown that the property in question qualified for this deduction. Since the property did not have an Idaho situs, this adjustment is affirmed.

The auditor also disallowed the $250,000 exclusion claimed by the petitioner pursuant to Internal Revenue Code § 121. Internal Revenue Code § 121 provided, in part, the following:

> Exclusion of gain from sale of principal residence. (a) Exclusion. Gross income shall not include gain from the sale or exchange of property 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 2 years or more.

There seems to be no question as to the ownership period being sufficient to qualify for the exclusion, but the auditor asserts that the use of the property during the five years prior to the sale was not sufficient to qualify for the exclusion. Section 1.121-1(c), Income Tax Regulations provides, in part, the following:

> Ownership and use requirements. (1) *In general*. The requirements of ownership and use for periods aggregating 2 years or more may be satisfied by establishing ownership and use for 24 full months or for 730 days (365 x 2). The requirements of ownership and use may be satisfied during nonconcurrent periods if both the ownership and use tests are met during the 5-year period ending on the date of the sale or exchange.
> (2) Use. (i) In establishing whether a taxpayer has satisfied the 2-year use requirement, **occupancy of the residence is required**. (Emphasis added.)

The petitioner contends that he is allowed the exclusion of the gain in question pursuant to Treasury Regulation § 1.121-3(e)(2)(iii)(D). This regulation prescribes the criteria for a "[r]educed maximum exclusion for taxpayers failing to meet certain requirements." Treasury Regulation § 1.121-3(e) states, in part, the following:

> Sale or exchange by reason of unforeseen circumstances.
> (1) In general. A sale or exchange is by reason of unforeseen circumstances if the primary reason for the sale or exchange is the occurrence of an event that the taxpayer could not reasonably have anticipated before purchasing and occupying the residence. A sale or exchange by reason of unforeseen circumstances (other than a sale or exchange deemed to be by reason of unforeseen circumstances under paragraph (e)(2) or (3) of this section) does not qualify for the reduced maximum exclusion if the primary reason for the sale or exchange is a preference for a different residence or an improvement in financial circumstances.
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> (2) Specific event safe harbors. A sale or exchange is deemed to be by reason of unforeseen circumstances (within the meaning of paragraph (e)(1) of this section) if any of the events specified in paragraphs (e)(2)(i) through (iii) of this section occur during the period of the taxpayer's ownership and use of the residence as the taxpayer's principal residence:
>
> (i) The involuntary conversion of the residence.
> (ii) Natural or man-made disasters or acts of war or terrorism resulting in a casualty to the residence (without regard to deductibility under section 165(h)).

(iii) In the case of a qualified individual described in paragraph (f) of this section—

(A) Death;

(B) The cessation of employment as a result of which the qualified individual is eligible for unemployment compensation (as defined in section 85(b));

(C) A change in employment or self-employment status that results in the taxpayer's inability to pay housing costs and reasonable basic living expenses for the taxpayer's household (including amounts for food, clothing, medical expenses, taxes, transportation, court-ordered payments, and expenses reasonably necessary to the production of income, but not for the maintenance of an affluent or luxurious standard of living);

(D) Divorce or legal separation under a decree of divorce or separate maintenance

The regulation provides that, had the petitioner moved from the residence for one of the prescribed reasons when he had owned or used the property as his "principal residence" for 20 months, for example, rather than 24 months, he would have been eligible for a reduced exclusion. Pursuant to the formula set out in this regulation, one may be entitled to a reduced exclusion if one or more of the criteria (e.g. ownership or use) was not sufficient to qualify for the full amount of the credit. Regulation § 1.121-3(g) sets out the computation of the reduced credit:

> 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 period of time that the taxpayer owned the property during the 5-year period ending on the date of the sale or exchange; 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 the period of time between the date of the prior sale or exchange of property for which the taxpayer excluded gain under section 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).

Applying the facts of this case, it would appear that the allowable exclusion pursuant to this regulation would be zero ((0/730) x $250,000) due to the petitioner not using the [Redacted] property as his "principal residence" during the five years prior to the sale of the property.

Treasury Regulation § 1.121-1(c)(4) provides examples, one of which states:

> Example (2). Taxpayer B owns and uses a house as her principal residence from 1986 to the end of 1997. On January 4, 1998, B moves to another state and ceases to use the house. B's son moves into the house in March 1999 and uses the residence until it is sold on July 1, 2001. B may not exclude gain from the sale under section 121 because she did not use the property as her principal residence for at least 2 years out of the 5 years preceding the sale.

From the information in the file, it appears that the petitioner moved out of the property in question in 1992. His wife lived in the property for some time after that, possibly until the date of the sale of the property. The petitioner contends that due to the specific facts and circumstances of the case, the literal requirement of occupancy of the property should be ignored.

In a somewhat similar case, the Ninth Circuit Court of Appeals commented as follows:

> Curtis Perry agreed to vacate his former residence and to postpone its sale. Meanwhile, he took up residence elsewhere and made his life in the new place. A house which a party to a divorce has agreed shall be the exclusive residence of the other spouse cannot, during the period covered by that agreement, be the "principal residence," under section 1034(a), of the person who has agreed to move out. It is true that not every aspect of a divorce is, strictly speaking, within the taxpayer's control; nevertheless, we agree with the Tax Court in Young that a "a divorce, while often unpleasant and unwanted, is uniquely personal and is not the type of external, objective circumstance that allows a taxpayer not in possession of a home to be deemed a resident therein for purposes of section 1034(a)." Young, 49 T.C.M. (CCH) 1002 (1985).

Perry v. Commissioner, 91 F.3d 82, 86 (9^{th} Cir. 1996).

The exclusion is for gain from the sale of the petitioner's *principal* residence. In 2006, the petitioner claimed another exclusion pursuant to Internal Revenue Code § 121 for the sale of his principal residence in Idaho. It appears that the petitioner contends that he concurrently had two "principal residences." A person has no more than one "principal" residence. Dwyer v. Matson, 163 F.2d 299, 302 (10th Cir.1947), Perry v. Commissioner, 91 F.3d 82, 85 (9th Cir. 1996).

Residence has been described as follows:

> The elements of residence are "abode and the intention of remaining." Stolk v. Commissioner, 40 T.C. 345, 353, (1963), aff'd, 326 F.2d 760 (2d Cir.1964). Both of these must in general be present. "Neither bodily presence alone nor intention alone will suffice to create a residence." Id. While literal definitions of "home" are elusive, here it is enough to agree with our sister circuit that a residence is "one's actual home, in the sense of having no other home, whether [one] intends to reside there permanently or for a definite or indefinite length of time." Dwyer v. Matson, 163 F.2d 299, 302 (10th Cir.1947).

Perry, *supra* at 85

It appears that the petitioner moved out of the [Redacted] property in 1992. It is not clear how many other "residences" he lived in from that time until the time of the sale of the [Redacted] property. He claimed that one Idaho "residence," which he bought on April 5, 2001, and sold on January 20, 2006, was his "principal residence" for purposes of Internal Revenue Code § 121. If one can have but one "principal residence," which one might it have been during the time that he lived in Idaho; the one that he lived in (in Idaho), or the one in [Redacted] which he had not lived in for more than a decade? The petitioner claims both.

Returning to the Perry decision, the court stated the following:

> [7] Furthermore, one year following the sale of the Irvine house, Curtis and Linda Perry, filing jointly, obtained nonrecognition treatment for Linda's house in La Mirada, where she and Curtis had been living together since 1984. Curtis Perry's divorce does not afford him the right to "reside" in two places at once for the

> purposes of section 1034(a). A person has no more than one "principal" residence. Dwyer, 163 F.2d at 302.

Perry, *supra* at 86.

The Commission finds that the petitioner has not demonstrated that his “principal residence” was at the [Redacted] property for any part of the five-year period preceding the sale. Accordingly, this adjustment is also affirmed.

WHEREFORE, the Notice of Deficiency Determination dated January 23, 2009, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax, penalty, and interest (computed to November 15, 2009):

YEAR	TAX	PENALTY	INTEREST	TOTAL
2005	$24,201	$2,420	$5,479	$32,100

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioner’s right to appeal this decision is enclosed.

DATED this _______ day of ____________, 2009.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of ________________, 2009, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]
[Redacted]

Receipt No.

____