**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

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| In the Matter of the Protest of | ) | |
| | ) | DOCKET NO. 0-926-262-272 |
| | ) | |
| | ) | |
| Petitioners. | ) | DECISION |
| | ) | |

The Income Tax Audit Bureau (Bureau) sent (Petitioners) a Notice of Deficiency Determination (Notice) for tax year 2021. Petitioners protested, disagreeing with the Bureau's denial of their Internal Revenue Code (IRC) section 121 primary home exclusion. The Tax Commission has reviewed the matter and hereby upholds the Notice issued by the Bureau.

## BACKGROUND

Petitioners filed a timely 2021 income tax return reporting a $110,543 gain on real estate held less than a year. On May 5, 2023, Petitioners filed an amended 2021 return, removing the capital gain and requesting a tax refund. The explanation of changes on Federal Form 1040-X Part III stated as follows: "Sale of personal residence was reported incorrectly on the original tax return. It originally was reported on Schedule D. Sales should have been reported as a sale of personal residence. Taxpayer lived in the home the entire time of ownership of the home." The Bureau processed the return and sent Petitioners a letter questioning the circumstances for removing the gain on the sale of their residence. The Bureau also questioned the reduction of the Idaho Child Tax Credit from $820 to $615. Petitioners responded and provided documentation to support the amended return. In summary, Petitioners argued they qualified for the IRC section 121 primary home exclusion due to a health-related move for their immediate family members. Their elderly parents contracted COVID-19, resulting in health complications. Petitioners claim that due to their close approximation to the local factory, the harsh smells exuding from the factory caused "difficult exacerbations of respiratory distress." For this reason, they decided to move to a more rural area to try to be around cleaner air. In regard to the Idaho Child Tax Credit, Petitioners stated the change was a mistake and their original return was correct.

Petitioners provided copies of medical records verifying their father contracting COVID-19 and subsequent pneumonia. The Bureau reviewed the information provided and denied the refund requested. Additionally, the Bureau added retirement income Petitioners failed to report and adjusted their Idaho Child Tax Credit back to the amount claimed on the original return. Petitioners protested, claiming the retirement income was a "traditional withdrawal" and was used to put a down payment on their new home and should not be taxable. They also continued to argue they qualified for the IRC section 121 primary home exclusion and stated they would provide additional medical records. Additional documentation was never provided, so the Bureau acknowledged their protest and transferred the case to the Tax Commission's Appeals Unit (Appeals).

Appeals sent Petitioners a letter on January 30, 2024, and subsequent emails in attempts to establish contact. Petitioners did not respond. Therefore, the Tax Commission must make its decision on the information currently available.

## LAW AND ANALYSIS

IRC section 121(a) provides that:

> "Gross income shall not include gain from the sale or exchange of property if, during the five-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."

If the taxpayers file married jointly, the excluded gain or exchange shall not exceed $500,000. Petitioners purchased the home in question on August 20, 2020, and subsequently sold the home on August 5, 2021, less than a year later. Under IRC section 121(a), Petitioners would not qualify for an exclusion of gain because they failed to meet the ownership time requirement. However, under IRC section 121(c)(2)(B), taxpayers can qualify for a partial exclusion of gain if: "such sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances."

Treasury Regulation 1.121-3(d) provides the details in qualifying for reason of health (**Emphasis added**):

> *(1) In general.* A sale or exchange is by reason of health if the primary reason for the sale or exchange is to obtain, provide, or facilitate the diagnosis, cure, mitigation, or treatment of disease, illness, or injury of a qualified individual described in paragraph (f) of this section, or to obtain or provide medical or personal care for a qualified individual suffering from a disease, illness, or injury. **A sale or exchange that is merely beneficial to the general health or well-being of an individual is not a sale or exchange by reason of health.**
>
> *(2) Physician's recommendation safe harbor.* A sale or exchange is deemed to be by reason of health if a physician (as defined in section 213(d)(4)) recommends a change of residence for reasons of health (as defined in paragraph (d)(1) of this section).

The Tax Commission has not received any documentation showing a physician's recommendation for a change of residence. As stated in the regulation above, a sale that is merely beneficial to the general health or well-being of an individual does not qualify for the exclusion. Therefore, Petitioners do not qualify for the IRC section 121 primary home exclusion and the decision made by the Bureau should be upheld.

Regarding the unreported retirement income, according to Petitioners' 1099-R forms, Box 7 showed a distribution code "1" and "1B." These codes refer to "early distribution, no known exemption" and "early distribution, Roth IRA." These distribution codes are taxable under IRC section 408A. Petitioners stated the distributions were used as a down payment for their home, but under IRC section 72(t)(2)(F), this would only shield them from early withdrawal penalties if the distributions were for a first-time home purchase. The income from the distribution is still taxable. Therefore, the addition of $10,140 of Idaho taxable income is hereby upheld.

**CONCLUSION**

Petitioners filed an amended 2021 return to claim the IRC section 121 exclusion on their primary home sale. The Tax Commission has reviewed the available information and verifies the Bureau's decision to deny Petitioners' requested refund, as they did not qualify for the exclusion. The Tax Commission also reviewed the addition of unreported retirement income and finds the adjustment to be appropriate due to the information included on their 1099-R forms.

THEREFORE, the Tax Commission AFFIRMS the Notice of Deficiency Determination dated November 1, 2023, directed to

It is ORDERED that Petitioners pay the following tax and interest:

| YEAR | TAX | INTEREST | TOTAL |
|---|---|---|---|
| 2021 | $660 | $47 | $707 |

Interest is included as required by Idaho Code section 63-3045 and is calculated through December 31, 2023.

An explanation of Petitioners' right to appeal this decision is enclosed.

DATED this _______ day of _________________ 2024.

IDAHO STATE TAX COMMISSION

**CERTIFICATE OF SERVICE**

I hereby certify that on this ________ day of ______________________________ 2024, 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:

Receipt No.

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