Reg. Section 1.121-2(a)(3)

Limitations.

(a) Dollar limitations –

(1) In general. A taxpayer may exclude from gross income up to $ 250,000 of gain from the sale or exchange of the taxpayer's principal residence. A taxpayer is eligible for only one maximum exclusion per principal residence.

(2) Joint owners. If taxpayers jointly own a principal residence but file separate returns, each taxpayer may exclude from gross income up to $ 250,000 of gain that is attributable to each taxpayer's interest in the property, if the requirements of section 121 [26 USCS § 121] have otherwise been met.

(3) Special rules for joint returns -- (i) In general. A husband and wife who make a joint return for the year of the sale or exchange of a principal residence may exclude up to $ 500,000 of gain if --

(A) Either spouse meets the 2-year ownership requirements of § 1.121-1(a) and (c);

(B) Both spouses meet the 2-year use requirements of § 1.121-1(a) and (c); and

(C) Neither spouse excluded gain from a prior sale or exchange of property under section 121 [26 USCS § 121] within the last 2 years (as determined under paragraph (b) of this section).

(ii) Other joint returns. For taxpayers filing jointly, if either spouse fails to meet the requirements of paragraph (a)(3)(i) of this section, the maximum limitation amount to be claimed by the couple is the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. For this purpose, each spouse is treated as owning the property during the period that either spouse owned the property.

(4) Examples. The provisions of this paragraph (a) are illustrated by the following examples. The examples assume that § 1.121-3 (relating to the reduced maximum exclusion) does not apply to the sale of the property. The examples are as follows:

Example 1. Unmarried Taxpayers A and B own a house as joint owners, each owning a percent interest in the house. They sell the house after owning and using it as their principal residence for 2 full years. The gain realized from the sale is $ 256,000. A and B are each eligible to exclude $ 128,000 of gain because the amount of realized gain allocable to each of them from the sale does not exceed each taxpayer's available limitation amount of $ 250,000.

Example 2. The facts are the same as in Example 1, except that A and B are married taxpayers who file a joint return for the taxable year of the sale. A and B are eligible to exclude the entire amount of realized gain ($ 256,000) from gross income because the gain realized from the sale does not exceed the limitation amount of $ 500,000 available to A and B as taxpayers filing a joint return.

Example 3. During 1999, married Taxpayers H and W each sell a residence that each had separately owned and used as a principal residence before their marriage. Each spouse meets the ownership and use tests for his or her respective residence. Neither spouse meets the use requirement for the other spouse's residence. H and W file a joint return for the year of the sales. The gain realized from the sale of H's residence is $ 200,000. The gain realized from the sale of W's residence is $ 300,000. Because the ownership and use requirements are met for each residence by each respective spouse, H and W are each eligible to exclude up to $ 250,000 of gain from the sale of their individual residences. However, W may not use H's unused exclusion to exclude gain in excess of her limitation amount. Therefore, H and W must recognize $ 50,000 of the gain realized on the sale of W's residence.

Example 4. Married Taxpayers H and W sell their residence and file a joint return for the year of the sale. W, but not H, satisfies the requirements of section 121 [26 USCS § 121]. They are eligible to exclude up to $ 250,000 of the gain from the sale of the residence because that is the sum of each spouse's dollar limitation amount determined on a separate basis as if they had not been married ($ 0 for H, $ 250,000 for W).

Example 5. Married Taxpayers H and W have owned and used their principal residence since 1998. On February 16, 2001, H dies. On September 24, 2001, W sells the residence and realizes a gain of $ 350,000. Pursuant to section 6013(a)(3) [26 USCS § 6013(a)(3)], W and H's executor make a joint return for 2001. All $ 350,000 of the gain from the sale of the residence may be excluded.

Example 6. Assume the same facts as Example 5, except that W does not sell the residence until January 31, 2002. Because W's filing status for the taxable year of the sale is single, the special rules for joint returns under paragraph (a)(3) of this section do not apply and W may exclude only $ 250,000 of the gain.

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