United States Tax Court

T.C. Memo. 2022-32

STEVEN W. WEBERT AND CATHERINE S. WEBERT,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 15981-17. Filed April 7, 2022.

P–W purchased a house in 2005, and Ps resided in it. P–W suffered multiple health problems that first caused her to draw on an equity line of credit to pay medical bills and eventually led her to attempt to sell the house, but the attempt failed. Beginning in 2009, Ps rented the house to third parties while trying from time to time to sell the property. Ps did not thereafter reside in the house.

P–W finally sold the house in 2015, realizing long-term capital gain pursuant to the sale. Ps reported the sale of the house on their 2015 return but claimed an exclusion of the gain from gross income under I.R.C. § 121.

In a statutory notice of deficiency, the IRS determined Ps were ineligible to exclude that capital gain under I.R.C. § 121. Ps filed with the Tax Court a petition for redetermination. R moved for partial summary judgment as to the capital gain. P–W consents to the entry of partial summary judgment, but P–H opposes it.

Held: R's motion for partial summary judgment will be granted in part on the issue of use of the property under I.R.C. § 121(a), because R showed that there is no genuine dispute that Ps did not use the house as their principal residence for at least two of the five years preceding the

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[*2] sale. However, R's motion will be denied in part without prejudice, because there is a genuine dispute of fact on the issue (first addressed in R's reply brief) of whether, under I.R.C. § 121(c)(2)(B), the sale was "by reason of a change in place of employment, health, or . . . unforeseen circumstances", and because R has not addressed whether, as a matter of law, this fact is material to the amount of the exclusion in this case.

Steven W. Webert, for himself.

Henry C. Cheng, *David F. Gross*, and *Amy N. Spivey*, for Catherine S. Webert.

*Amy Chan*g and *Alicia H. Eyler*, for respondent.

MEMORANDUM OPINION

GUSTAFSON, *Judge*: The Internal Revenue Service ("IRS") issued to petitioners Steven W. Webert and Catherine S. Webert statutory notices of deficiency ("SNODs") pursuant to section 6212,[1] determining deficiencies and additions to tax for six years[2] including 2015.

The Weberts timely petitioned this Court for redetermination of the deficiencies pursuant to section 6213(a). Respondent, the Commissioner of the IRS, has filed a motion for partial summary judgment, asserting that the Weberts do not meet the requirements of section 121 and therefore may not exclude from their 2015 gross income the capital gain realized on the sale of their house on Mercer Island, Washington (the "Mercer Island house"). For the reasons stated below, we will grant the Commissioner's motion in part and deny it in part.

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[1] Unless otherwise indicated, statutory references are to the Internal Revenue Code, Title 26, U.S.C., as in effect at all relevant times; all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times; and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] Although the Weberts filed joint returns for the years 2010, 2011, 2012, 2013, 2014, and 2015, the IRS issued SNODs for these years to each of the Weberts individually.

[*3] *Background*

For the reasons explained in part I.A of the Discussion below, we assume for purposes of the Commissioner's motion the facts that he has shown to be not subject to genuine dispute, drawing all reasonable inferences in favor of Mr. Webert, the non-movant. Those assumed facts are as follows.

The Weberts' background

The Weberts married in 2004. In 2005 Ms. Webert was diagnosed with cancer, for which she had extensive surgery. In that same year, she purchased the Mercer Island house, where the Weberts allege, and we assume, they resided from 2005 through 2009.

Medical problems and financial hardship

Ms. Webert's health problems immediately became a financial challenge, and she took out a line of credit on the property, which (she explained) the Weberts used "to pay for medical insurance premiums and other medical expenses as she was becoming very ill". After 2005 Ms. Webert continued to suffer numerous accumulating and cascading health problems, which required multiple treatments and for which they accrued extensive medical bills. Ms. Webert's health conditions reduced her working capacity permanently, which contributed to an extended period of financial hardship.

Rental and sale of the Mercer Island house

Ms. Webert attempted to sell the Mercer Island house beginning in 2009, but for years she was unsuccessful. As Ms. Webert explained:

> The financial and housing markets crashed in 2008 and hit the Seattle area particularly hard, so the house in Mercer Island would not sell when funds were needed to make the payments and to pay Ms. [Webert]'s mounting health premiums, medical, and dental bills.
>
> The house was in escrow and the sale fell through before it finally got rented out in sheer desperation, because [Mr. Webert] was no longer able to pay the payments. I believe it was for sale at different points during the rental time. After another realtor was enlisted,

[*4] before it finally sold [in 2015] it was in escrow again and the sale fell through yet another time.

The Weberts did not reside at the Mercer Island house after 2009. Rather, Mr. Webert owned a second house in Sammamish, Washington, where the Weberts evidently resided during the years at issue. They began renting the Mercer Island house to third parties in 2009, and it remained rented for the entire year in 2010, 2011, 2012, and 2013, from January through July in 2014, and from March through June in 2015. The Weberts did not use the Mercer Island house personally for any substantial period in 2010 or at all from 2011 through 2015–even during the periods in which it was not rented.

Ms. Webert sold the Mercer Island house on October 20, 2015, for $1,140,000 and realized $194,752 of long-term capital gain pursuant to the sale. In sum, Ms. Webert owned the property for roughly 11 years (2005–15), of which she used it as her principal residence for 5 years (2005–09) and used it as rental property for 6 years (2010–15).

The Weberts were divorced in 2016 (after the years at issue).

Federal income tax returns

The Weberts filed joint federal income tax returns for the years 2010, 2011, 2012, 2013, 2014, and 2015 no earlier than December 15, 2016, more than a year after the sale of the Mercer Island house.[3] The Weberts reported the sale of the Mercer Island house on Schedule D, "Capital Gains and Losses", attached to their 2015 Form 1040, "U.S. Individual Income Tax Return", but they excluded the realized gain on the sale from their gross income.

The Weberts also reported income from their lease of the Mercer Island house each year on Schedule E, "Supplemental Income and Loss", attached to their return. Schedule E requires a taxpayer to report the amount of time the rental real estate property is rented to third parties or used personally by the taxpayer. Schedule E has been revised over the years. For 2010 the Weberts reported that they did not use the Mercer Island house "during the tax year for personal purposes for more than . . . 14 days or 10% of the total days rented at fair rental value". The Schedules E for 2011 through 2015 asked the Weberts to report

[3] The date the Weberts filed their returns is in dispute, but our resolution of the Commissioner's motion does not require a determination on this issue.

[*5] specifically the number of days in the year they rented the Mercer Island house at fair rental value and the number of days they used the property for personal use. The Weberts reported 365 fair rental days and zero personal use days of the Mercer Island house for 2011, 2012, and 2013, 212 fair rental days and zero personal use days for 2014, and 122 fair rental use days and zero personal use days for 2015.

The Weberts also attached to each return a "Depreciation and Depreciation Re-capature [sic]" schedule. Each depreciation schedule lists the precise dates that the Mercer Island house spent in rental service during the year. Mirroring the fair rental days reported on the Schedules E, the depreciation schedules reflect that the Weberts rented the Mercer Island house to third parties for 12 months each year from 2010 through 2013, for 7 months in 2014, and for 4 months in 2015. The depreciation schedules indicate that, during the entire 2010 through 2015 period, the Mercer Island house spent only 11 months out of rental service.

Both of the Weberts signed each return below the preprinted statement that reads:

> Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete.

Notice of deficiency and petition

After receiving the Weberts' returns for 2010–15, the IRS issued SNODs (and, shortly thereafter, supplemental SNODs) determining deficiencies totaling $231,371 for the 2015 tax year,[4] partially due to an adjustment including $194,752 of capital gain in gross income from sale of the Mercer Island house.

The Weberts timely filed a petition in this Court contesting the IRS's determinations. Pursuant to Rule 121, the Commissioner filed a

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[4] We aggregate the deficiencies the Commissioner determined for Ms. Webert ($123,768) and Mr. Webert ($107,603) for ease of discussion. The Commissioner allocated half the gain from the sale of the Mercer Island house to each of them. The deficiencies and additions to tax the IRS determined for 2010, 2011, 2012, 2013, and 2014 are in dispute but are not the subject of the Commissioner's motion for partial summary judgment.

[*6] motion for partial summary judgment contending that there is no genuine dispute of material fact regarding whether the Weberts may exclude from gross income the capital gain realized from the sale of the Mercer Island house. Specifically, the Commissioner argues that the Weberts failed to use the Mercer Island house as their principal residence for the requisite period under section 121(a). Ms. Webert does not oppose the Commissioner's motion. Mr. Webert opposes the Commissioner's motion, generally denying the correctness of the Commissioner's fact statements and seeming to assert in his response (but not in any affidavit or declaration) that the Weberts did use the Mercer Island house as a residence and that the reasons for the sale included Ms. Webert 's health problems. The Commissioner argues (in his reply) that the Weberts may not exclude the capital gain realized because—in addition to their failure to use the Mercer Island house—the primary reason for the sale was not a change in place of employment, health, or unforeseen circumstances (as required by section 121(c)(2)(B)).

Discussion

I. *General principles of law*

A. *Summary judgment standard*

The Court may grant summary judgment when there is no genuine dispute as to any material fact and a decision may be rendered as a matter of law. Rule 121(b); *Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), *aff'd*, 17 F.3d 965 (7th Cir. 1994). A partial summary adjudication is appropriate if some but not all issues in the case may be decided as a matter of law, even though not all the issues in the case are disposed of. *See* Rule 121(b); *Turner Broad. Sys., Inc. & Subs. v. Commissioner*, 111 T.C. 315, 323–24 (1998).

The moving party (here, the Commissioner) bears the burden of showing that no genuine dispute of material fact exists, and the Court will make factual inferences in the light most favorable to the nonmoving party (here, Mr. Webert). *Dahlstrom v. Commissioner*, 85 T.C. 812, 821 (1985). However, Rule 121(d) imposes a duty on a party resisting summary judgment:

[*7] When a motion for summary judgment is made and supported as provided in this Rule, an adverse party may not rest upon the mere allegations or denials of such party's pleading, but such party's response, by affidavits or declarations or as otherwise provided in this Rule, must set forth specific facts showing that there is a genuine dispute for trial. If the adverse party does not so respond, then a decision, if appropriate, may be entered against such party.

B. *Exclusion of gain from sale of principal residence*

Gross income means all income from whatever source derived, unless specifically excluded by law. *See* § 61(a); Treas. Reg. § 1.61-1(a). Generally, gain realized on the sale of property is included in a taxpayer's income. § 61(a)(3). Section 121, however, excludes gain on the sale or exchange of property from gross income in certain circumstances.

1. *Section 121(a) and (b)*

Section 121(a) excludes gain on the sale of property if the taxpayer has both "owned and used" such property as her principal residence for at least two of the five years immediately preceding the sale. The term "principal residence" means "the chief or primary place where a person lives or . . . the dwelling in which a person resides." *Gates v. Commissioner*, 135 T.C. 1, 7 (2010) (emphasis omitted). Whether property is used by the taxpayer as the taxpayer's residence depends upon all the facts and circumstances. Treas. Reg. § 1.121-1(b)(1).

The maximum exclusion of gain from a residence is $250,000 for an individual, § 121(b)(1), or $500,000 for joint returns under section 121(b)(2)(A) "if—(i) either spouse meets the ownership requirements of subsection (a) with respect to such property; (ii) both spouses meet the use requirements of subsection (a) with respect to such property;" and the taxpayers meet a third condition not in dispute here.

If the spouses do not collectively meet the requirements of section 121(b)(2)(A), the spouses may exclude an amount of gain equal to the sum of the exclusion amount to which each spouse would be entitled if they had not been married. § 121(b)(2)(B); *see also* Treas. Reg. § 1.121-2(a)(4) (example 4). For the purposes of this analysis, each spouse is treated as owning the property during the period in which

[*8] either spouse owned the property. § 121(b)(2)(B). Thus, under this provision, some exclusion may be claimed if either spouse (not necessarily the taxpayer who is the owner) used the property as a principal residence.

For a taxpayer who qualifies under section 121(a) (because she satisfies the ownership and use requirements) but has some "periods of nonqualified use" of the property, section 121(b)(5) provides for computing the exclusion by allocating gain to "periods of nonqualified use" (which gain is then not excluded). Under section 121(b)(5)(C)(ii)(III), those "periods of nonqualified use" do not include a "period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or . . . other unforeseen circumstances". But this computation of nonqualified use is called for only in the instance of a taxpayer who otherwise meets the use requirement.

2. *Section 121(c)*

A taxpayer who fails to satisfy the ownership or use requirement under section 121(a) and (b) may nonetheless qualify for a reduced exclusion amount if, under section 121(c)(2)(B), the "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 provides safe harbors in which a sale or exchange is deemed to be by reason of a change in place of employment, health, or unforeseen circumstances. Under those provisions, a sale or exchange is deemed to be by reason of health if a physician recommends a change of residence for reasons of health. Treas. Reg. § 1.121-3(d)(2).

If a safe harbor does not apply, "a sale or exchange is by reason of a change in place of employment, health, or unforeseen circumstances only if the *primary reason* for the sale or exchange is a change in place of employment . . . , health . . . , or unforeseen circumstances". Treas. Reg. § 1.121-3(b) (emphasis added).

However, this special exclusion of section 121(c) has its own limitation: The amount of the exclusion that might otherwise have been permitted for an exclusion under section 121(a) (i.e., limited for a single return to $250,000 or for some joint returns to $500,000 under section 121(b)(1) or (2)) is multiplied by a fraction defined by the statute. The numerator is defined (as relevant here) in section 121(c)(1)(B)(i)(I) as—

[*9] the aggregate periods, during the 5-year period ending on the date of such sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence—

—and the denominator is defined in section 121(c)(1)(B)(ii) as "2 years" (or 730 days or 24 months, depending on the measure of time used in the numerator). *See* Treas. Reg. § 1.121-3(g)(1). Consequently, if a single taxpayer has (for example) owned her house for only one year and is forced to sell it because of a change in place of employment, her one-year ownership will fail to qualify under section 121(a) for the $250,000, but that one year of ownership as a numerator over the two-year denominator of section 121(c)(1)(B)(ii) will give her a fraction of one over two. This hypothetical taxpayer may therefore exclude one-half of the $250,000 amount, or $125,000. But to get any exclusion under this special rule of section 121(c), the taxpayer must have resided in the house for at least one day (or else the numerator of the fraction will be zero, and the exclusion amount will therefore likewise be zero).

II. *Analysis*

A taxpayer who files a return other than a joint return and who meets the ownership and use requirements of section 121(a) is entitled to the exclusion under section 121(b)(1). The use requirement is two years' use as a principal residence in the five years before the sale (which we refer to as "two-out-of-five-years use requirement"). However, the Weberts filed a joint return for the 2015 tax year, and they may exclude the capital gain realized on the sale of the Mercer Island house from their gross income only if they satisfy the ownership and use requirements of section 121(b)(2)(A) or (B), or the requirements of section 121(c).

A. *The use requirements of section 121(b)(2)*

1. *The two exclusions under section 121(b)(2)(A) and (B) both impose a use requirement.*

Ms. Webert owned the Mercer Island house continuously from 2005 through 2015, and the Weberts thus satisfy the ownership requirements of section 121(b)(2)(A) and (B). The only dispute in this case is as to the use requirements. To qualify for a $500,000 gain exclusion under section 121(b)(2)(A), both spouses must satisfy the two-out-of-five-years use requirement of subsection (a).

[*10] If unable to meet that requirement, then under section 121(b)(2)(B) they may exclude an amount of capital gain equal to the sum of each spouse's qualifying exclusion amount determined on a separate basis as if they had not been married—i.e., determined for each of them as if under section 121(a) and (b)(1), with the two-out-of-five-years use requirement of section 121(a) applied separately to each spouse.

Consequently, whether the Weberts qualify for any capital gain exclusion either under section 121(b)(2)(A) ($500,000) or under section 121(b)(2)(B) (with its limitation) hinges on whether either or both of the Weberts satisfy the two-out-of-five-years use requirement.

2. *The Weberts do not meet that use requirement.*

We hold that the Commissioner has established that there is no genuine dispute as to the fact that neither of the Weberts used the Mercer Island house as a personal residence for any of the years 2010 through 2015. The Weberts' returns for the years 2010 through 2015—signed by the Weberts under penalty of perjury—demonstrate their lack of personal use of the Mercer Island house. The Schedules E and the depreciation schedules attached to each return show that the Weberts rented out the Mercer Island house to third parties for all but 11 months from 2010 to 2015. Mr. Webert does not offer specific factual support "by affidavits or declarations or as otherwise provided in [Rule 121]" for the proposition that he used the Mercer Island house as his principal residence at any point in the five years preceding its sale—only his general allegation (in his response and not in an affidavit or declaration) that "[the Mercer Island house] was used [by the Weberts] as a principal residence during the five years prior to its eventual sale".

This broad generalization, made in contradiction of his own previous and specific accounting, cannot create a genuine dispute of fact. Under Rule 121(d) Mr. Webert "may not rest upon the mere allegations or denials of [his] pleading, but [his] response, by affidavits or declarations or as otherwise provided in this Rule, must set forth specific facts showing that there is a genuine dispute for trial." He offers no specific facts to dispute the fair rental days (or zero personal use days) that he reported on the Schedules E and the depreciation schedules, which directly contradict his current claim of personal use. Therefore, Mr. Webert has failed to make any actual showing that the Weberts (or either of them) used the Mercer Island house as their principal residence for the requisite period, and the Weberts accordingly cannot meet the

[*11] use test to qualify for a capital gain exclusion under section 121(b)(2)(A) or (B).

B. *"Health" in section 121(b)(5)(C)(ii)(III) and (c)(2)(B)*

As we noted, taxpayers who claim an exclusion under section 121(b)(2) may avoid a characterization of "nonqualified use" where they were temporarily absent from the property because of "health conditions" (or other circumstances), § 121(b)(5)(C)(ii)(III); and taxpayers who fail to meet the ownership and use requirements of section 121(a) and (b) may qualify for a lesser exclusion amount under section 121(c) if the "sale . . . is by reason of . . . health" (or other circumstances), § 121(c)(2)(B). Mr. Webert's opposition to the Commissioner's motion invokes both of these "health" provisions, and the Commissioner replies to the effect that Mr. Webert did not show the requisite causal connection between the health problems and the absence or the sale. We think these health-related issues are not subject to summary disposition at this point.

1. *There appear to be genuine disputes of fact.*

During the period at issue, it is clear that the Weberts suffered many unfortunate and prolonged difficulties. They are not mentioned in the Commissioner's motion (Doc. 53); they are alluded to in Mr. Webert's response (Doc. 60); and in Ms. Webert's response, those problems and their effects are described in some detail in an attachment (Doc. 57 at "Page 11" to "Page 16") to her Form 8857, "Request for Innocent Spouse Relief", which was signed under penalty of perjury. It seems clear that Ms. Webert 's health was both a cause of the need to move from the Mercer Island house and a precipitating cause for the financial circumstances that contributed to that need. However, in his response to the Commissioner's motion for summary judgment, Mr. Webert did not anticipate the Commissioner's arguments (for which we do not blame him), and he therefore did not argue that any of these difficulties fall under the safe harbors enumerated under Treasury Regulation § 1.121-3(b) nor that they were the "primary reason" for the sale of the Mercer Island house in 2015. If we draw all reasonable inferences in Mr. Webert's favor (as Rule 121 requires), it appears that the health problems may have been the primary reason for the attempts to sell which began in 2009 and did not succeed until 2015. Consequently, we find a genuine dispute on that factual issue, and we assume that health reasons *were* the primary reason for the sale. We cannot grant partial summary judgment to the Commissioner on the

[*12] section 121 exclusion issue if, in order to do so, we must assume otherwise.

2. *It is not yet clear whether the facts about Ms. Webert's health are material.*

However, it is not clear to us that the facts about Ms. Webert 's health and its effect on the sale are actually material to this case. Because the Commissioner's motion did not mention health problems, it did not discuss or even cite section 121(b)(5)(C)(ii)(III) or (c)(2)(B). Mr. Webert's response cited them but said little else. The Commissioner's reply did not analyze the statute but explained why the health problems did not (in his view) really constitute the primary reason for the sale. But when we analyze the statute without substantial help from the parties, the health problems seem not to affect the outcome.

As we have explained, under section 121(b)(5)(C)(ii)(III), temporary absence due to "health conditions" may avoid being characterized as "nonqualified use" for purposes of the allocation under section 121(b)(5)(A). But as we understand the statute, one undertakes this allocation only in the case of taxpayers who have otherwise shown an entitlement to the exclusion under section 121(a) and (b)—i.e., to a taxpayer who has met the ownership *and use* requirements. It appears to us that the "health conditions" provision of section 121(b)(5)(C)(ii)(III) (unlike the "health" provision of section 121(c)(2)(B)) does not abrogate the use requirements, and neither party has argued that it does or does not. They seem instead to have assumed that it does, and it does not seem that that assumption is correct.

As for section 121(c), which we explained briefly above, it appears to be a different sort of provision. By its terms "the . . . use requirement[] of subsection (a) . . . shall not apply", § 121(c)(1), where the "sale . . . is by reason of . . . health", § 121(c)(2)(B). But this provision does not merely drop the use requirement in an instance in which health problems prompted the sale. Rather, it sets up an alternative limitation, which also turns on "use": It creates a fraction that is multiplied to potentially reduce the exclusion amount that would otherwise be claimed. The denominator of that fraction is two years and the numerator is "the aggregate periods, during the 5-year period ending on the date of such sale or exchange, such property has been owned *and used* by the taxpayer as the taxpayer's principal residence". § 121(c)(1)(B)(i)(I) (emphasis added). If the taxpayer can show two years

[*13] of residential use in the last five, then her fraction is two over two (i.e., a whole one), and she gets the entire exclusion amount. If she can show only one year of residential use, then her faction is one over two (i.e., one-half), and she gets half the exclusion amount. But if her residential use during the five-year period ending on the date of the sale was zero (as the Weberts' was), then it appears her fraction is zero over two, and she gets a zero exclusion.

If this is correct, then we need no trial on health problems, in view of the fact (as to which we hold there is no genuine dispute) that neither of the Weberts resided in the Mercer Island house during the five years before the sale in 2015. If either of the parties believes that this is not correct, then we need additional argument from them.

Conclusion

In conclusion, we hold that there is no genuine dispute of material fact regarding whether, for the years 2010 through 2015, the Weberts did not use the Mercer Island house as their principal residence for purposes of section 121(a) and (b). There *is* a genuine dispute of fact regarding whether the primary reason for the Weberts' sale of the Mercer Island house was Ms. Webert 's health, but the parties have not yet addressed whether, as a matter of law, that disputed fact is a "material" fact. We will therefore grant the Commissioner's motion in part and deny it in part.

To reflect the foregoing,

An appropriate order will be issued.