Murphy v. Commissioner, 103 T. C. 111 (1994)

When spouses file a joint return and sell a jointly owned residence, each spouse can defer their share of the gain under Section 1034 if they purchase a new residence, but they remain jointly and severally liable for the tax on any gain not deferred by the other spouse.

Summary

William H. Murphy and his then-wife sold their jointly owned home in 1988, deferring the gain under Section 1034 by intending to purchase replacement residences within two years. After separation, only Murphy bought a new home within the period, leading to a dispute over the tax treatment of the gain. The Tax Court held that Murphy could defer his half of the gain by purchasing a new residence, but was jointly and severally liable for the tax on his ex-wife's half of the gain, which she did not defer due to not buying a new home. The court also upheld negligence and substantial understatement penalties against Murphy.

Facts

In December 1988, William H. Murphy and his wife sold their jointly owned residence in Illinois for $475,000, realizing a gain of $185,629. They filed a joint tax return and deferred the gain under Section 1034 by indicating their intention to purchase new residences within two years. The couple separated in December 1989 and were divorced in May 1991. Within the two-year period, Murphy purchased a new residence in Arizona for $199,704, but his ex-wife did not buy a replacement home. Murphy filed an amended return, reporting $37,506 of the gain as taxable, reflecting his half-share of the gain minus the cost of his new home.

Procedural History

The Commissioner of Internal Revenue issued a deficiency notice to both Murphy and his ex-wife, determining a deficiency of $45,035 and penalties for negligence and substantial understatement of income tax. Murphy filed a petition with the Tax Court, contesting the deficiency and penalties. His ex-wife did not join in the petition or file one on her own behalf. The Tax Court held that Murphy could defer his half of the gain under Section 1034 but was jointly and severally liable for the tax on his ex-wife's half of the gain.

Issue(s)

1. Whether Murphy can defer his allocable one-half of the total gain realized on the sale of the jointly owned residence under Section 1034.
2. Whether Murphy is jointly and severally liable under Section 6013 for the tax on the gain that must be recognized due to his ex-wife's failure to purchase a replacement residence.
3. Whether Murphy is subject to additions to tax under Sections 6653(a) and 6661

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for negligence and substantial understatement of income tax, respectively.

Holding

1. Yes, because under Rev. Rul. 74-250, each spouse's gain is calculated separately, and Murphy's reinvestment of his half-share in a new residence allowed him to defer his portion of the gain.
2. Yes, because Section 6013(d)(3) imposes joint and several liability for taxes on a joint return, and Murphy's ex-wife did not defer her half of the gain by purchasing a new residence.
3. Yes, because Murphy did not contest the penalties and failed to provide evidence that he was not negligent or that the understatement was not substantial.

Court's Reasoning

The court applied Rev. Rul. 74-250, which allows each spouse to defer their half of the gain from a jointly owned residence if they purchase a new residence within the statutory period. Murphy's purchase of a new home allowed him to defer his half of the gain, but his ex-wife's failure to purchase a new home meant her half of the gain was immediately taxable. The court also relied on Section 6013(d)(3), which imposes joint and several liability for taxes on a joint return, making Murphy liable for the tax on his ex-wife's half of the gain. The court upheld the penalties under Sections 6653(a) and 6661, noting that Murphy did not contest them and failed to provide evidence to rebut the Commissioner's determinations.

Practical Implications

This decision clarifies that when spouses sell a jointly owned home and file a joint return, each can defer their share of the gain under Section 1034 by purchasing a new residence within the statutory period. However, they remain jointly and severally liable for any tax on the gain not deferred by the other spouse. This ruling impacts how attorneys should advise clients on tax planning for the sale of jointly owned property, especially in the context of impending divorce. It also serves as a reminder of the importance of considering joint and several liability when filing joint returns. Subsequent cases have cited this ruling in similar contexts, reinforcing its application in tax law.

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