

Vacation and Second Homes

DO THEY QUALIFY UNDER IRC §1031?

Sellers who own vacation or second homes often want to explore the potential of performing an IRC §1031 Tax-Deferred Exchange. Although a black and white answer is often difficult to provide, many tax and legal advisors believe it is possible to include a vacation or second home in an exchange. The vacation property may have no rental history but may still be considered "held for investment purposes." The primary intent of the client holding the property is the key factor when evaluating a potential vacation home exchange.

PRIOR TAX LAW RULINGS

In Private Letter Ruling (PLR) 8103117, the IRS did allow tax deferral even though the investment property was acquired for personal enjoyment and as an investment. PLR 8103117 states, "...the house and lot you acquire in this trade will be held for the same purposes as the property exchanged: to provide for personal enjoyment and to make a sound real estate investment." Even though the property had never been rented but was acquired with the expectations of appreciation, it may still qualify for a §1031 Tax-Deferred Exchange.

In a decision rendered May 30, 2007, *Barry E. Moore v. Commissioner*, T.C. Memo. 2007-134 provided a significant case concerning whether a vacation home would be considered "held for investment." The court concluded that "...the mere hope or expectation that the property may be sold at a gain cannot establish investment intent if the taxpayer uses the property as a residence."

REVENUE PROCEDURE 2008-16

On February 15, 2008, the IRS issued Revenue Procedure 2008-16, providing a safe harbor definition of investment property effective March 10, 2008. Should a relinquished or replacement property qualify under this safe harbor, the IRS will not challenge whether the dwelling unit qualifies as a property held for use in trade or business or investment purposes.

The IRS will not challenge the status of a home as held for investment if:

- 1) The taxpayer owns both the relinquished and the replacement property at least 24 months immediately before or 24 months immediately after the exchange; AND
- 2) Within each of the two 12 month periods immediately preceding or subsequent to the exchange, the taxpayer must:
 - Rent the property to another person or persons at a fair rental for 14 or more days; AND
 - The taxpayer's personal use of the dwelling unit cannot exceed the greater of 14 days or 10 percent of the number of days during the 12 month period the dwelling unit is rented at a fair rental.

This is just a safe harbor. An Exchange may still fall outside the parameters and meet the statutory requirements, but you should expect heightened scrutiny in such a case.

