



**OUR BUSINESS PRINCIPALS**

**SECURITY**

Industry-leading security measures that ensure exchange fund liquidity and principal protection

**KNOWLEDGE**

Expert team of CPAs, MBAs, and attorneys that provide exchange guidance for forward, reverse, build-to-suit construction, leasehold, international, personal property, multi-asset, and other complex exchanges

**SERVICE**

A significant value-adding resource with exceptional client service and innovative strategies that complement core business objectives

An Insight into:

**Vacation Home / Second Home 1031 Exchanges**

Exchanges under Internal Revenue Code §1031 are often referred to as “Like-Kind” exchanges due to the requirement that exchanged properties must be like-kind to one another. The like-kind requirement for real estate is broadly defined, thus allowing taxpayers to exchange, for example, raw land for a residential mountain rental property, or an office building for a beachfront duplex.

*Qualified Property*

In order to qualify for exchange treatment, property must be held for investment or used in a trade or business. Determining whether an asset is held for investment requires a facts-and-circumstances analysis of how the asset is treated by the taxpayer (See *Moore v. Comm., TC Memo. 2007-134*). For example, investment real estate is typically depreciated by the taxpayer while non-investment property is generally not. Further, investment property is not purchased for immediate resale purposes -- such property is treated as inventory, and is therefore, excluded from exchange treatment. Personal residences and property held primarily for personal use do not qualify as being like-kind, and therefore may not be exchanged. However, such disqualified real estate may be converted into property qualified for exchange treatment by means of a change in how the taxpayer treats and uses the property.

*Safe Harbor Rules*

IRS *Rev. Proc. 2008-16, 2008-10 IRB* provides safe harbor guidance under which the IRS will not challenge whether a dwelling unit (including vacation or second homes and condominiums) qualifies for exchange treatment. This Revenue Procedure outlines rental standards, establishes a qualifying use period, and concludes that limited personal use will not prevent a dwelling unit from qualifying as being held with an investment intent. Elements of these safe harbor guidelines include:

- the taxpayer owning the relinquished property for at least 24 months immediately before the exchange and the replacement property for at least 24 months immediately after the exchange
- within each of the two 12-month periods immediately preceding and following the exchange, (i) the taxpayer rents the dwelling unit to others at a fair rental for 14 days or more, and (ii) the period of the taxpayer’s personal use of the dwelling unit does not exceed the greater of 14 days OR 10 percent of the number of days during the 12-month period that the dwelling unit is rented at a fair rental.

Taxpayers should note that this is only a safe harbor, meaning that transactions falling outside these prescribed guidelines may still qualify for tax deferral benefits.

*Personal Use Considerations*

Taxpayer are deemed to have used a dwelling unit for personal purposes on any day the unit is used by: (A) the taxpayer or any person who has an interest in the unit, or by any member of the taxpayer’s family; (B) any individual who uses the unit under a reciprocal agreement which enables the taxpayer to use some other dwelling unit (whether or not a rental fee is charged for the use of such other unit); or (C) any individual if rented for less than fair market value rental. The taxpayer may rent the dwelling unit to a family member if the family member uses it as a principal residence and the family member pays fair market rent. Additionally, some taxpayer use may be allowed for performing repairs and annual maintenance without being included in the number of person days used.

Please contact Strategic 1031 Exchange Advisors with any exchange questions regarding tax-deferred property exchanges.

**STRATEGIC EXCHANGE ADVISORS**

