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## New guidance regarding vacation and second home exchange

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Just in time for a hopeful spring in home sales, there is new guidance out from the IRS regarding vacation and second homes being sold as part of a tax deferred exchange. To date, we had known that a second home with strictly personal use would not qualify for a 1031 exchange, and in 2007 heard from the IRS merely holding a personal use property with the hope of future gain was not enough to qualify the property as held for investment under the code (*Moore v. Commissioner T.C. Memo 2007-434*). However, the biggest question still remained: "How long do I have to rent it out before I can do a section 1031 exchange?"

Effective for tax deferred exchanges on or after March 10th, the IRS creates a safe harbor and will not challenge whether a dwelling unit that is either a relinquished property or a replacement property in a §1031 Exchange qualifies as property held for use in a trade or business or for investment purposes. A dwelling unit is defined as "real property improved with a house, apartment, condominium, or similar improvement that provides basic living accommodations including sleeping space, bathroom and cooking facilities."

The safe harbor for a second home to now qualify as relinquished property in a §1031 exchange requires the Exchanger to:

- 1) have owned it for 24 months immediately before the sale/exchange, and
- 2) rented it at fair market rental for fourteen days or more within each of the past two 12-month periods the exchanger, and
- 3) the taxpayer must have restricted his or her personal use to not exceed the greater of fourteen days or ten percent of the total number of days that it was rented within each of those 12-month periods.

In addition, the safe harbor for a second home to qualify as replacement property in a §1031 exchange requires the exchanger to own the vacation home for 24 months immediately after the exchange, and for each of those 12-month periods the exchanger must:

- 1) rent the unit at fair market rental for fourteen or more days, and
- 2) restrict personal use to the greater of fourteen days or ten percent of the number of days it was rented within that 12-month period.

Additionally, if the replacement property purchased in the §1031 exchange is also a second home, the safe harbor requires the exchanger also own this new dwelling unit for 2 full years immediately after the exchange, and meet the same itemized criteria as noted above.

For a copy of the revenue procedure or to discuss a particular scenario which may qualify, contact me at 877-781-1031 and always consult with tax and/or legal counsel before making any decision regarding the exchange of property. The IRS did not comment on the treatment of properties that

do not fall within this safe harbor, but this should come as good news to many taxpayers and advisor's - the guessing game is no longer required and we now have concrete information straight from the IRS!

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