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New changes to rule by: Wayner of Bayview 1031

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If the taxpayer files its federal income tax return and reports the transaction as a Section 1031 Exchange, believing that the second-vacation home used as a replacement property will meet the appropriate qualifying standards, and then it is determined that this replacement property does not meet the necessary qualifying standards, the IRS will suggest that the taxpayer file an amended return and not report the transaction as an exchange under Section 1031.

Rev. Proc. 2008-16 is limited in that it only determines whether a dwelling unit qualifies as property held for productive use in a trade or business or for investment under Section 1031. It does not give safe harbor protection for all of the other requirements for a "like kind" exchange under Section 1031 or under the Section 1031 regulations.

What happens if the second-vacation home does not qualify under Rev. Proc. 2008-16 for safe harbor protection? The taxpayer may still try to qualify for Section 1031 treatment but will have to overcome the requirements set forth in Rev. Proc 2008-16. The effective date of Rev. Proc. 2008-16 is March 10, 2006.

Rev. Proc. 2008-16 does clear the air on many of the foggy issues surrounding 1031 Exchanges for vacation and second homes. That said, taxpayers will still have to satisfy any and all of the other requirements for a like-kind exchange in order to qualify for tax deferred treatment.

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