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Understand limits of “personal use” in 1031 like-kind exchanges - by Bill Lopriore

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Many people own rental properties in vacation locations and want the benefits of tax-deferred exchanges while still enjoying their property for personal use. However, too much personal use and not enough rental use can disqualify the property for tax-deferred treatment under Internal Revenue Code Section 1031. The Internal Revenue Service issued Revenue Procedure 2008-16, providing guidance on these issues.

The revenue procedure includes nuanced requirements that must be met to avoid the risk of losing the tax deferral benefit. For example, the taxpayer must own the relinquished and replacement properties for at least 24 months immediately before and after the exchange. Yet, in each of the 12-month periods immediately before and after the exchange, the properties must also be rented at a fair market value to an unrelated party for a minimum of 14 days. During each 12-month period, the taxpayer’s personal use cannot exceed the greater of 14 days or 10% of the days that the property was rented at fair market value to anyone other than family members (a rental to family counts toward taxpayer’s personal use unless rented at fair market value and used as their principal residence). Additional requirements define what constitutes visits to the property for maintenance and clarify what type of use by family members and other parties may count as “personal use.” The parameters can be complex, so owners of vacation homes should speak with a 1031 like-kind exchange specialist or real estate attorney before pursuing an exchange.

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