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Vacation and second homes: You may be able to defer 100% of your capital gains tax - by Robert Charland

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Do you have a second home or vacation home that you are thinking of selling? Did you know that you may be able to defer 100% of your capital gains tax from the sale of the property? IRC §1031 allows you to sell qualified use property, property you hold for investment or for productive use in trade or business, and to defer tax on the gain if you use the proceeds to purchase one or more like kind properties. Your vacation home or second home may constitute qualified use property if you hold the property for any of the following reasons:

- The property is held primarily for appreciation and the incremental increase in value because of the passage of time.
- The property is rented or made available for rent at fair market value and your personal use of the property is less than 14 days a year or 10% of the time rented, whichever is greater.
- You report the income and expenses from the property on your tax return in a manner consistent with holding the property as qualified use property. For example, if you hold property primarily for appreciation, the mortgage interest expense should be capitalized and added to your basis in the property and not listed as an itemized deduction on Schedule A.

If you hold the property primarily for personal use, it will not qualify for an exchange. If you allow relatives or friends to use the house, or rent the house to others at below fair market rent, their use will be deemed personal use by you and the house will not qualify for a tax-deferred exchange.

Some examples of vacation or second homes that qualify for an exchange are:

Seasonal Home: A seasonal home you have owned for several years which you have rented to tenants or made available for rent for the entire season each year. You have not used the home personally. You have reported the rental income on your personal tax return and taken deductions

for all expenses and depreciation. The home is held for productive use in a trade or business and qualifies for an exchange.

Second Home: You have owned a second home for some years. For the past three years you have not rented the home, you have not made the home available for rent and you have not used the home personally. The home has been vacant for the past three years. You have capitalized the mortgage interest. The property is held primarily for investment and will qualify for an exchange.

Vacation Home: You have owned a vacation home which you have rented to tenants or made available to rent for several years at fair market rent. They have all paid fair market rent. You have used the home personally each year for less than 10% of the total days the property has been rented. Your primary use of the home is property held for productive use in a trade or business. Your home will qualify for an exchange.

Second Home: Several years ago, you and your sibling(s) inherited your parents' principal residence. Since then, the value of the house has increased substantially. You hold title to the property as tenants in common. Up until now all the siblings have not been able to reach an agreement on the disposition of the house, which remains vacant. In order to help resolve the differences, you have offered to sell your interest to your sibling(s). Your interest in the house constitutes qualified use property having been held by you for investment and may be exchanged.

Examples of properties that do not qualify for an exchange are:

- **Rental/Personal Use Property:** You have owned the home for several years and rented it occasionally to tenants. Last year you used the home personally for a number of days in excess of 14 days and in excess of 10% of the total days the property was rented or made available for rent. The property is deemed personal use property and does not qualify for an exchange.
- **Personal Use Property.** Over the past several years you have not attempted to rent your vacation home. You have personally used the home most weekends. You have deducted mortgage interest and real estate taxes on Schedule A, Form 1040. The home is held as personal use property and does not qualify for an Exchange.
- **Personal Use Property.** You have rented your second home all season to relatives, friends or others at below market rates. You have not used the house personally. The house is still considered personal use property and will not qualify for an exchange.

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