



## NEW 1031 VACATION HOME SAFE HARBOR GUIDELINES

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Effective for property closings after March 9, 2008, the IRS will not challenge whether a vacation property qualifies for Section 1031 treatment if certain specified ownership and use requirements are met. The IRS released Revenue Procedure 2008-16 providing definite guidelines for a safe harbor vacation property 1031 exchange.

A vacation property or dwelling unit for purposes of this revenue procedure is real property improved with a house, apartment, condominium or similar improvements that provide basic living accommodations including sleeping space, bathroom and cooking facilities.

This safe harbor while addressing the vacation home criteria in a round about way may give guidance on converting a 1031 replacement property into a primary residence after an exchange. It appears that a taxpayer may need to wait 2 years after an exchange to convert the 1031 replacement property into their primary residence. Additionally, this replacement property should be rented out at fair market rent for at least 14 days during each year during the two 12 month periods after the exchange.

Specifically to meet the safe harbor requirements, a taxpayer, during the 24 months prior to the sale of their vacation home or the 24 months after the purchase of their vacation property as a 1031 replacement property must:

Rent the property at fair market rent for a minimum of 14 days during each 12 month period of the 24 - month period.

Limit personal use of the property during each 12 month period of the 24 -month period not to exceed the greater of: 14 days or 10 percent of the number of days the property is rented at a fair market rent during each of the two 12 month periods.

The IRS defined personal use to include:

1. The taxpayer or any other person who has an interest in the vacation property including a tenant in common interest.
2. Use by any individual who uses the property under an arrangement which enables the taxpayer to use some other property. For example, trading vacation property use whether or not a rental

is charged for the use of such other property is considered personal use.

3. Use by any member of the family of the taxpayer unless the vacation property is rented out as a primary residence at a fair market rent.
4. Use by any other individual if rented for less than fair market rent.

Per the IRS, the "fair market rent" is determined based on all of the facts and circumstances that exist when the rental agreement is entered into, and all rights and obligations of the parties to the rental agreement are taken into account.

Some taxpayer usage is not considered as personal use if the taxpayer is engaged in repair, upkeep and annual maintenance on a substantially full time basis for any day. The taxpayer must be ready to prove that the actual work was done.

In summary, a taxpayer can take a personal residence or a vacation home and rent it to a friend for 14 days per year for two years and then exchange out of it. Remember that personal use must be limited during these two years! Likewise, the taxpayer can rent their replacement 1031 property for 14 days per year for two years after the exchange and prior to conversion to a principal residence.

This new Revenue Ruling provides a wonderful safe harbor and taxpayers must also satisfy all other requirements for a like-kind exchange under IRC Section 1031. If your vacation property does not meet all the terms of the safe harbor it may still be possible to do a 1031 exchange but you could be subject to heightened scrutiny. There are many tax rules for a 1031 exchange and the taxpayer will also need to meet those requirements. Always check with your tax advisor before engaging in any 1031 exchange.

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