

## **Vacation Homes May Qualify For Tax Deferred 1031 Exchanges**

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A common question our clients ask is whether their vacation home (or second home) qualifies for a 1031 tax deferred exchange. The answer is "probably." This answer hinges on the actual use of the property by the owner. The IRS has somewhat clarified their position in Revenue Procedure 2008-16, which became effective March 10, 2008. The Services' guidance acts to provide a set of specific circumstances known as a "safe harbor." If a vacation home, second home, or a primary residence that has been converted to an investment property meets the criteria of Revenue Procedure 2008-16, then it would be considered "qualified use property" and become eligible for 1031 treatment. The Safe harbor criteria for property the investor is selling (relinquished property) are:

- The property must have been owned and held by the investor for a minimum of 24 months immediately preceding the Exchange
- The property has been rented out at fair market value rental rates to other people for at least 14 days or more during each of the proceeding 2 years
- The investor limited his or her personal use to no more than 14 days during each of the proceeding 2 years, or 10% of the number of days that the property was actually rented out to other people during each of the proceeding 2 years

The Investor may buy a vacation home or second home as a qualifying replacement property in a 1031 exchange if these safe harbor requirements are met:

- The subject property is owned and held by the investor for at least 24 months immediately following the 1031 exchange
- The subject property will be rented at fair market value to other people for at least 14 days (or more) during each of the following 2 years
- The investor limits his or her personal use of the property to no more than 14 days during each of the following 2 years, or 10% of the number of days that the subject property was actually rented out to other people each of the following 2 years
- The use of the property by the family members of the investor is considered as "use<sup>[E1]</sup> by the investor," unless the family members pay fair market rental and the subject property is their primary residence

It is important to note that exchanges may still be successfully completed on vacation or second home properties that do not follow some or all of the Revenue Procedure 2008-16 guidelines. However, the prudent investor should always check with their legal and tax advisors to determine if their property was held for productive use in trade, business, or investment purposes.

*\*IRS Reg. 1.1031(a)1(b) \*\*Private Letter Ruling 8103117*

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