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"Your 1031 Exchange Specialist"



Certified Exchange Specialist on Staff

Vacation Home Alert!! Over the past six months or so, the IRS has issued more guidance on what it would look at when deciding whether a vacation/2nd home would qualify for 1031 tax-deferral treatment. On February 15, 2008, the IRS issued Revenue Procedure ("Rev. Proc.") **2008-16**, effective for exchanges occurring on or after March 10, 2008, which provides a safe harbor for exchanges of vacation homes ("dwelling unit"). Taxpayers must satisfy qualifying use standards during the 24-month period prior to the exchange.

Relinquished Property

For a dwelling unit to qualify as relinquished property, it must meet the following criteria:

- 1) The dwelling unit is owned by the taxpayer for at least 24 months immediately before the exchange (the "qualifying use period"); **and**
- 2) Within the qualifying use period, in each of the two 12-month periods immediately preceding the exchange:
 - (a) the taxpayer rents the dwelling unit at fair rental to another person or persons for 14 days or more **and**
 - (b) the taxpayer's personal use of the dwelling unit does not exceed the greater of 14 days or 10 percent of the number of days during the 12-month period that the dwelling unit is rented at fair rental.

The first 12-month period immediately preceding the exchange ends on the day before the exchange takes place (and begins 12 months prior to that day) and

the second 12-month period ends on the day before the first 12 month period begins (and begins 12 months prior to that day).

Replacement Property

For a dwelling unit to qualify as replacement property, it must meet the following criteria:

- 1) It is owned by the taxpayer for at least 24 months immediately following the exchange ("qualifying use period"); **and**
- 2) Within the qualifying use period, in each of the two 12 month periods immediately after the exchange:
 - a) the taxpayer rents the dwelling unit to another person or persons at fair rental for 14 days or more **and**
 - b) the taxpayer's personal use of the dwelling unit does not exceed the greater of 14 days or 10 percent of the number of days during the 12-month period that the dwelling unit was rented at fair rental.

The 12-month period immediately after the exchange begins on the day after the exchange takes place and the second 12 month period begins on the day after the first 12-month period ends.

Personal Use. Use by the taxpayer or other person having an interest in the dwelling unit and any family member (includes siblings, spouse, ancestors and lineal descendants) will be considered "personal use" by the taxpayer. Also, any arrangement whereby fair market rent is not paid will be considered "personal use" by the taxpayer. However, use by family members will not be considered "personal use" by the taxpayer **if the dwelling unit is rented at fair market rent and the family member uses it as his principal residence.**

Fair rental. Fair rental is determined based upon all of the facts and circumstances that exist when the rental agreement is entered into. All rights and obligations of the rental agreement are taken into account.

Special rule for replacement property. If the taxpayer files a return reporting a transaction as an exchange under §1031 based on the expectation that the dwelling unit will meet the qualifying use standards and subsequently determines that the dwelling unit does not meet the qualifying use standards, the taxpayer, if necessary, should file an amended return and not report the transaction as an exchange under §1031.

Exchanges of 2nd/vacation homes outside the Rev. Proc. 2008-16 safe harbor. An exchange of a vacation home may still qualify under §1031 even though it falls outside the parameters of Rev. Proc. 2008-16. Any such

circumstance will be subject to greater scrutiny and therefore should be carefully planned and reviewed by the taxpayer's tax advisor.

The above is merely an overview and is not to be construed as tax advice. A taxpayer should always consult his/her tax advisor to determine the treatment of all of your costs associated with the relinquished and replacement property closings and to determine the exact amount the taxpayer needs to reinvest to fully defer his/her gain.

Should you have any items which you would like to see addressed, we welcome your feedback.

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