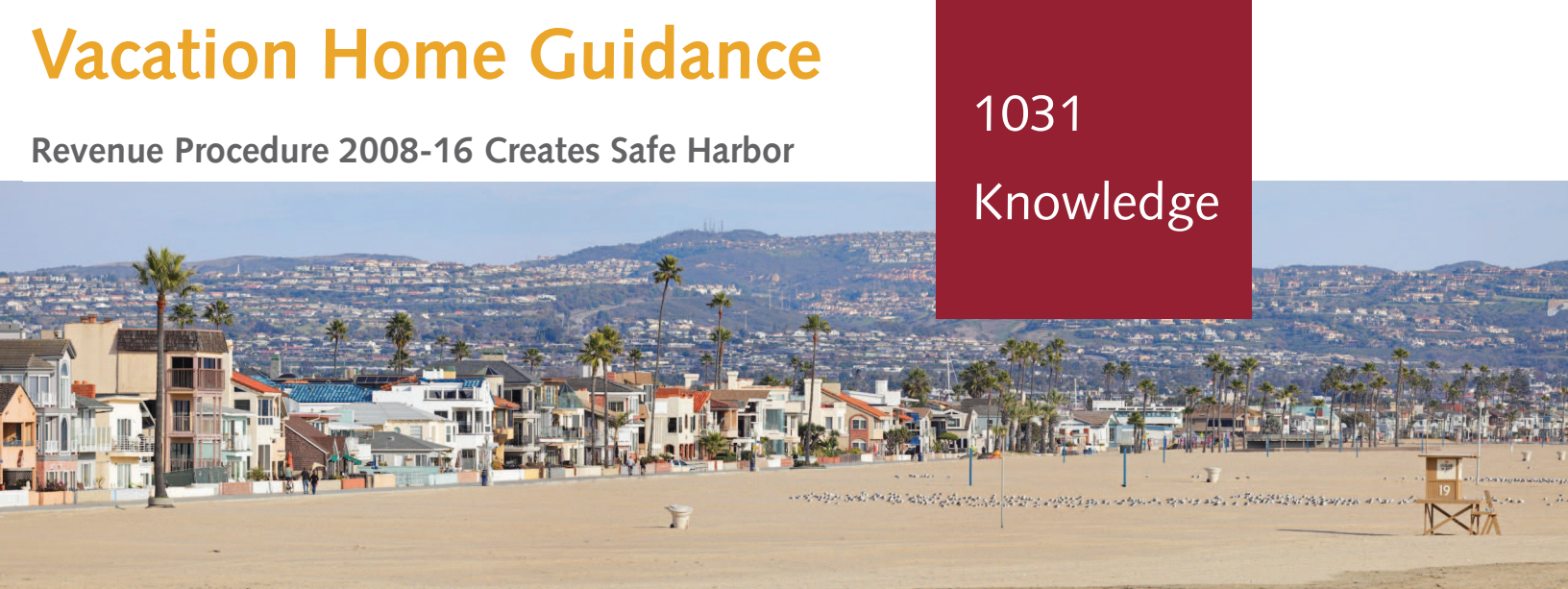


Vacation Home Guidance

Revenue Procedure 2008-16 Creates Safe Harbor

1031

Knowledge



[Revenue Procedure 2008-16](#) (the “Procedure”) created a safe harbor definition of investment property applicable to IRC Section 1031 exchange transactions closing after March 10, 2008, that involve the transfer of property consisting of a dwelling unit (defined below) and/or the acquisition of a dwelling unit as replacement property. In short, the IRS will not challenge whether a residential property or vacation home property is held for productive use in a trade or business or for investment if certain specified ownership and use requirements are met. This safe harbor Procedure provides useful guidance on the characterization of vacation property and may also be useful for planning purposes such as the conversion of a principal residence into a qualifying relinquished property.

REQUIREMENTS OF REVENUE PROCEDURE 2008-16

A dwelling unit is defined as any real property improved with a house, apartment, condominium, or similar improvement that provides basic living accommodations including a sleeping space, bathroom and cooking facilities (e.g., a residential property). The IRS will not challenge whether a dwelling unit qualifies as §1031 exchange like-kind property held for productive use in a trade or business or for investment if: (1) the relinquished property is owned by the taxpayer for at least 24 months immediately prior to the 1031 exchange and a replacement property is owned for at least 24 months immediately after the 1031 exchange (the “qualifying use period”), and, (2) within each of the two 12-month periods constituting the qualifying use period, the taxpayer must:

- a) Rent the property to another person or persons at a fair market rent for 14 or more days; and,
- b) The taxpayer’s personal use of the dwelling unit cannot exceed the greater of 14 days or 10 percent of the number of days during the 12-month period the dwelling unit is rented at a fair market rent.

Under the Procedure, personal use of a dwelling unit occurs on any day in which the taxpayer is deemed to use the property for personal purposes under §280A(d)(2) (taking into account §280A(d)(3) but not §280A(d)(4)). Thus, personal use includes: (1) use by the taxpayer or any other person who has an interest in the property or by a family member; (2) use by any individual who uses the unit under an arrangement which enables the taxpayer to use some other dwelling unit (whether or not a rental is charged for the use of such other unit); or (3) use by any other individual if rented for less than fair market value. A taxpayer can rent the property to a family member if the family member pays fair market rent. Whether a dwelling unit is rented at a fair market rental rate is determined based on all the facts and circumstances that exist when the rental agreement is entered into. All rights and obligations of the parties to the rental agreement are taken into account.

The Procedure provides a safe harbor for purposes of characterizing investment property for purposes of IRC §1031. Of course, any qualifying 1031 exchange must meet all other applicable legal requirements of §1031. Every taxpayer should consult with their legal and tax advisor before engaging in any 1031 exchange to review their unique facts and circumstances.

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