



# 1031 SAFE HARBOR FOR VACATION HOMES

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Vacation homes have long been a source of angst among exchangers and their advisors because of the lack of guidance on whether they qualify as an investment property for IRC §1031 purposes. A recent Revenue Ruling by the IRS seeks to clarify a recent tax court ruling on the subject and provide clearer guidance.

Generally, potential exchangers referenced Private Letter Ruling 8103117, in which the Internal Revenue Service ruled that a taxpayer could acquire a vacation home where the acquisition reasons were stated as being for investment purposes as well as for personal enjoyment. The PLR states that 'the house and lot you acquire in this trade will be held for the same purposes as the properties exchanged: to provide for a personal enjoyment and to make a sound real estate investment.' Accordingly, exchangers would claim that in addition to enjoying the vacation home personally they also purchased the property as an investment, and thus, it would qualify as a 1031 exchange. However, although this PLR gave exchangers a certain amount of comfort, a PLR is not a ruling that can be relied upon by anyone other than the person to whom the letter was given. In most cases a ruling that could not be relied upon from over twenty five years ago was cold comfort to all but the most aggressive of exchangers.

However, after a quarter of a century of indifference on the topic the Tax Court in 2007 restricted and more clearly defined the ability to structure vacation home exchanges. In *Moore v. Commissioner* (T.C. Memo. 2007-134) the Tax Court, citing to *Bolker v. Commissioner*, 81 T.C. 782 (1983), *aff'd* 760 F.2d 1039 (9th Cir.

1985), found that vacation homes held primarily for personal use are not consistent with 'held for investment' requirement of IRC §1031. The Service argued that the taxpayers' primary purpose in holding the properties should control any 'held for' determination, while the taxpayers argued that the holding requirement of §1031 is satisfied if 'investment' is one of several purposes in holding the properties (likely referring back to PLR 8103117). In its analysis, the court agreed with the Service that the taxpayer's primary intent of ownership for the properties was for personal use, not investment, and thus denied the exchanges. The general view is that the exchange will qualify if the requirements of §280A(d) are met. That section addresses business deductions on property that are used for personal use by the taxpayer, so long as the taxpayer's personal use of the property does not exceed the greater of 14 days or 10 percent of the number of days that the property was rented at fair value to others. For purpose of computing personal use, any time spent at the property for maintenance or other business related reasons are not to be counted against the taxpayer.

While the Moore ruling seemed to close the door on the matter the just released Revenue Procedure 2008-16 has provided some additional guidance and restrictions. While most of the Rev. Proc appears to be influenced by the Moore ruling there have been some changes. The Rev. Proc. first limits the scope of the ruling as only pertaining to "Dwelling Units", which are defined as "real property improved with a house, apartment, condominium, or similar improvement that provides basic living accommodations including sleeping space,

bathroom and cooking facilities." The Rev. Proc. thereafter defines the "Qualifying use standards" of a relinquished property dwelling unit as: a) the dwelling unit is owned by the taxpayer for at least 24 months immediately before the exchange (defined as the "qualifying use period"); and b) within the qualifying use period, in each of the two 12-month periods immediately preceding the exchange, (i) the taxpayer rents the dwelling unit to another person or persons at a fair rental for 14 days or more, and (ii) the period of the taxpayer's personal use of the dwelling unit does not exceed the greater of 14 days or 10% of the number of days during the 12-month period that the dwelling unit is rental at a fair rental. The rules for the purchase of a replacement property mimic the rules for a relinquished property, except that the qualifying activities are prospective.

While this Rev. Proc. does appear to provide real clarity to exchangers wishing to exchange vacation homes, it also establishes an unneeded restriction on the exchangeability of a vacation homes by limiting the ownership to a 24 month period. The Rev. Proc. also does not address situations in which the owner discontinues its personal use of the property and attempts to exchange when the ownership is less than the 24 month period. It would appear that while certain questions have been answered there will need to be further clarification for certain circumstances.

