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UPDATE: New 1031 Safe Harbor Ruling Regarding Vacation Homes and Dwelling Units

By Jeffrey C. O'Brien, Attorney at Law

In our February 2008 eWatch, guest columnist Neil Friedman of 1031 IPX discussed exchanging vacation homes using Section 1031 of the Internal Revenue Code. The Internal Revenue Service has recently issued a Revenue Procedure affecting this practice.

On February 15, 2008, the Internal Revenue Service ("IRS") issued Revenue Procedure 2008-16 as an attempt to clarify taxpayer uncertainty with respect to "dwelling units" utilized as relinquished and/or replacement property as part of a Section 1031 exchange. The Revenue Procedure provides a safe harbor under which the IRS will not challenge whether a dwelling unit qualifies as "property held for productive use in a trade or business or for investment" for like-kind exchange treatment under Section 1031. The Revenue Procedure also follows the recent decision in *Moore v. Commissioner* and the Treasury Inspector General Report which each addressed issues surrounding the exchange of vacation homes.

Specifically, the Revenue Procedure provides that a taxpayer's exchange involving "dwelling units" will fall within the safe harbor if each of the following factors is satisfied for both the relinquished and replacement properties:

- The taxpayer owns the property for at least 24 months immediately before and after the exchange ("qualifying use period");
- The taxpayer rents the property for at least 14 days each of the two 12 month periods immediately preceding and following the exchange; and
- The taxpayer's personal use of the property during each of the two 12 month periods immediately preceding and following the exchange is limited to the greater of 14 days or 10 percent of the number of days the property is rented for "fair rental" during corresponding 12 month period.

Although not addressing every circumstance, Rev. Proc. 2008-16 does provide some much needed certainty for many taxpayers engaged in exchanges involving vacation homes and rental property. The effective date of the Revenue Procedure is March 10, 2008.

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