

VACATION HOME EXCHANGES - BASICS

"INTRODUCTION TO EXCHANGES IN VACATION/RESORT AREAS"



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Taxpayers use Internal Revenue Code (IRC) §1031 tax deferred exchanges to defer paying capital gain taxes on the sale of property held for investment or used in a trade or business. Many tax and legal advisors believe it is possible to perform an exchange on a vacation property, provided the personal use is incidental and the taxpayer can substantiate that the primary purpose was holding the property for investment, not personal use.

TAX GUIDANCE FROM COURT DECISIONS AND A PLR

In *Barry E. Moore v. Commissioner* (2007), the tax court determined that the taxpayer's primary intent for holding both their relinquished and replacement vacation property was personal use, not investment. See Asset Preservation's handout entitled, "Vacation Home Exchanges - Barry E. Moore v. Comm.", for a more detailed analysis and review of this significant vacation home decision.

In the tax court case, *Rivera v. Commissioner* (2004), the tax court noted that, "...the term 'income' is not confined to recurring income but may also apply to gains from the disposition of property." In this case, the court found the taxpayers held the property for investment purposes because they had purchased it with the expectation it would increase in value. The court referenced Section 1.183-2 (b) of the Income Tax Regulations which outlines nine factors indicating whether or not a taxpayer is involved in a venture that is intended to produce a profit.

Another reference for tax guidance on vacation home exchanges comes from Private Letter Ruling (PLR) 8103117 which states "...the house and lot you acquire in this trade will be held for the same purposes as the properties exchanged: to provide for personal enjoyment and to make a sound real estate investment." Although a PLR only applies to the facts and circumstances in a specific situation, in this instance, some limited personal enjoyment of a property did not prevent a taxpayer from benefiting from a §1031 exchange. In this PLR, however, it is important to note that the personal use was minimal on the relinquished property in the years before the taxpayers sold this property and entered into a §1031 exchange.

ISSUES TO CONSIDER IN VACATION HOME EXCHANGES

Any taxpayer contemplating an exchange of a property in a vacation or resort destination area should be able to substantiate that their primary objective was investment, not personal use. This may be supported with documentation establishing their investment intent at the time of purchase (or conversion, if a second home is converted to a rental vacation property at a later date), through efforts to rent the property, by rental income and by treating the property as investment, as opposed to residence, on the tax return. Always consult with a knowledgeable tax and/or legal advisor in any §1031 tax deferred exchange.



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