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Safe Harbors for Vacation Homes and Conversions to or from Personal Residences

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The IRS has recently provided guidance to taxpayers to help ensure the validity of §1031 exchanges beginning March 10, 2008. This guidance is provided via a new safe harbor which sets forth guidelines which, if followed, provides the IRS will not challenge whether a dwelling unit will qualify for an exchange. The IRS specifically addressed vacation homes and indirectly the conversion of a relinquished or replacement property into an exchange.

A safe harbor simply provides a way to complete an exchange without being challenged by the IRS on a particular issue. It is very important to understand that an exchange may not meet the guidelines provided under the safe harbor and still qualify under the statutory requirements. However, the IRS indicates those that do not fall under the safe harbor provision will be subject to scrutiny.

Under the safe harbor a relinquished and/or replacement property qualifies for an exchange if it is:

1. owned by the taxpayer for at least 24 months immediately before/after an exchange, and
2. in each of the two 12-month periods before/after the exchange:
 - a. the taxpayer rents the relinquished property to another person at a fair rental for 14 days or more, and
 - b. the taxpayer's personal use does not exceed the greater of 14 days or 10% of the number of days during the 12-month period that the relinquished property is rented at a fair rental.

A few of the factors the IRS considers in determining whether a dwelling has been used for personal use include whether the dwelling is used by the taxpayer or any member of the taxpayer's family and whether the fair market rent is charged for rental purposes. A dwelling unit is most commonly a house, apartment or condominium. The best way to ensure a vacation home or primary residence will qualify for an exchange under the safe harbor is to limit taxpayer use to 14 days or less and rent it out for fair market rent for at least 14 days to an unrelated party.

Exchange Resources, Inc. specializes in straight-forward, simultaneous, build-to-suit, reverse and personal property exchanges. We also have attorneys on staff who provide personalized attention to complex issues and are available to discuss exchange matters with taxpayer's tax and legal advisors. Exchange Resources, Inc. also provides information in Spanish.