1031 Exchange FOCUS

SECTION 1031 OF THE INTERNAL REVENUE CODE IS ONE OF THE GREATEST WEALTH BUILDING TOOLS AVAILABLE TO INVESTORS

> Vacation Homes and 1031 Exchange

Internal Revenue Code Section 1031 allows investors to defer the payment of capital gains taxes when selling investment property.

When selling real estate, there are two beneficial tax laws available, depending on how the property was used prior to the sale. For property used as a principal residence, sellers can potentially qualify for a tax-exemption of up to $500,000 in capital gains under Section 121 of the Internal Revenue Code. For property used as an investment, sellers can defer all of their capital gains taxes by exchanging the property under Section 1031, also known as a 1031 Exchange. Most properties are easily categorized as either a principal residence or an investment. However, for second homes that can be used both as a vacation home and an investment rental, there are questions as to the tax benefits available when the property is sold.

In order to properly examine the issue of tax benefits available when selling vacations it is best to do so categorically.

The property is used exclusively for the owner's vacations:

When a property is used exclusively by the owners as a second home and is not rented out to others, capital gains should not be deferred using 1031 exchange.

The property is used exclusively for other people's vacations

When a property is rented to others for their vacations, and is not used by the owners, the property will qualify for tax deferral when sold if done so pursuant to a properly structured 1031 exchange.

The property is used for both the owner's vacations and other's vacations

Revenue Procedure 2008-16 provides a number of safe-harbor guidelines that would permit an investor to exchange a vacation property used by the owner and rented out. However, the following guidelines should be met:

1. The property was owned for at least 2 years prior to the sale and it was also rented, for fair market rent, for at least 14 days or more during the 2 years prior to the sale.
2. Personal use of the property by the owner was limited to the greater of 14 days per year during each of the 2 years prior to the sale or 10% of the number of days the property was actually rented out.

Phone: (877) 471-1031 info@ax1031.com

Fax: (877) 480– 1031 www.ax1031.com

Asset Exchange Company