



EXCHANGE TAX ALERT

IRS REVENUE PROCEDURE 2008-16

SAFE HARBOR

IRS WILL NOT CHALLENGE IF A DWELLING UNIT WITH PERSONAL USE QUALIFIES FOR 1031 EXCHANGE

New IRS Revenue Procedure 2008-16 is effective for exchanges of dwelling units occurring on or after March 10, 2008.

The purpose of the Revenue Procedure 2008-16 is to provide a Safe Harbor under which the IRS will not challenge whether a dwelling unit with limited personal use qualifies as property held for productive use in a trade or business or for investment for purposes of Section 1031 of the Internal Revenue Code. The Revenue Procedure says, “The Service recognizes that many taxpayers hold dwelling units primarily for the production of current rental income, but also use the properties occasionally for personal purposes.”

The Revenue Procedure applies to a dwelling unit that meets the Qualifying Use Standards. For this Revenue Procedure a dwelling unit is real property improved with a house, apartment, condominium, or similar accommodations including sleeping space, bathroom and cooking facilities.

The Qualifying Use Standards established in Section 4 of this Revenue Procedure are new. If the standards are met, the IRS will not challenge whether the dwelling unit is held for a qualifying use in an exchange. The Qualifying Use Standards can be applied to either the relinquished property or the replacement property.

The Qualifying Use Standards set forth in Revenue Procedure 2008-16 are:

- a) that the dwelling unit with limited personal use is owned at least 24 months before the exchange if it's the relinquished property, or 24 months after the exchange if it's the replacement property.
- b) that, within the applicable 24 month qualifying use period, in each of the two 12-month periods, the taxpayer rents the dwelling unit to another unrelated person or persons at fair value rental for 14 days or more. A related person may rent at fair value if the dwelling is a principal residence for the related person (§§280A(d)(2) & 280A(d)(3)).
- c) that the property must be a dwelling unit.

A taxpayer utilizing the Safe Harbor in this Revenue Procedure also must satisfy all other requirements for a like-kind exchange under Section 1031 and the regulations there under.

Analysis:

This Revenue Procedure is just a Safe Harbor. An exchange may fall outside these specific parameters and yet still meet the statutory requirements for an exchange.

If you want to use the Safe Harbor, the Revenue Procedure looks at each property to determine if personal use is too high and if actual rental income is generated. If you have a relinquished dwelling with personal use, we now know that you should own it 2 years before an exchange, rent it to someone other than direct family at fair value for at least 14 days in each of the 2 years, and limit personal use to 14 days or 10% of the days rented, whichever is larger. The same logic applies if the dwelling unit is your replacement property -- own the replacement 2 years after an exchange, rent it to someone other than direct family at fair value at least 14 days in each of the 2 years, and limit personal use to 14 days or 10% of the days rented, whichever is larger.

For years we have been asked “How much personal use is too much?” and “How long do I have to hold?” Many taxpayers dream about eventually moving into their rental property and converting it to a principal residence. Section 121 of the tax code defining the tax treatment on our homes even provides for this eventuality (§121(d)(10)). This Revenue Procedure provides a Safe Harbor answer when you are completing an exchange.

This publication is designed to provide accurate information on tax-deferred exchanges. The publisher is not engaged in rendering legal or accounting services. If legal or tax advice is required, the services of a competent professional should be sought.

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