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## Vacation Home Revenue Procedure 2008-16

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Since last fall 2007 we had been expecting additional guidance from the IRS on vacation rental homes. The IRS has now published Revenue Procedure 2008-16 for the purpose of providing 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. 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 Revenue Procedure says, "The Service recognizes that many taxpayers hold dwelling units primarily for the production of current rental income, but that they also use the properties occasionally for personal purposes." This Revenue Procedure applies to the exchange of dwelling units occurring on or after March 10, 2008.

The Qualifying Use Standards established in Section 4 of the 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 are applied to either the relinquished property or the replacement property and 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)); and 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.

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 if you wish to use the safe harbor, 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 of 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. In March 2008 the IRS published [Fact Sheet 2008-18](#), entitled “Like-Kind Exchanges Under IRC Code Section 1031.” In the fact sheet the IRS explains exchange property qualifications, time limits, identification rules, importance of a Qualified Intermediary, computation of basis, and reporting the exchange. For more detailed instructions [purchase](#) the book *How To Do A Like-Kind Exchange of Real Estate: Using a Qualified Intermediary* by Ed Horan.

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