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INVESTORS CAN USE 1031 EXCHANGE PROCEEDS TO PURCHASE A VACATION HOME



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You may or may not know that the IRS allows real estate investors to delay paying taxes on capital gains realized from the sale of investment properties. This is done through what is commonly referred to as a 1031 tax deferred exchange whereby a property owner sells an investment property and uses the sale proceeds to immediately purchase another investment property without paying capital gains tax. Until recently, it was not clear whether a vacation home could be considered an investment property for the purposes of a 1031 exchange. Earlier this year, the IRS issued guidelines which, if met, would qualify an investor's vacation home to be considered an eligible investment property under §1031 of the Internal Revenue Code.

First, the property owner must have owned the vacation property for at least 24 months immediately before selling in a 1031 exchange (the qualifying use period). Similarly, a property owner purchasing property as part of a 1031 exchange must own the vacation property for at least 24 months immediately after the exchange. Second, the property owner must have rented the property at fair market value for at least 14 days for each 12 month period within the 24 month qualifying use period. Third, the property owner cannot use the property for personal use for more than the greater of 14 days or 10% of the number of days during each 12 month period that the property was rented. For example, if the property owner rented the property for 50 days within the first 12 month period, he or she could still use the property for 14 days, but if the property owner rented the property for 250 days within the first 12 month period, he or she could still use the property for 25 days.

The guidelines also indicate that any day used for the purpose of performing repair or maintenance on the property does not count as a day of personal use. The IRS allows maintenance days for property owners to make repairs provided that the days used in making these repairs are reasonable in light of the circumstances, including the extent of the repairs.

The ability to purchase or sell a vacation home as part of a 1031 exchange could provide additional opportunities for investors who are seeking to own investment properties other than apartment buildings or other standard commercial properties. However, investors must keep detailed records of all activities regarding their vacation properties, including rental records, repairs made and the days used for said repairs, as proof that they have met the IRS guidelines pertaining to the use of the vacation property as an investment property. Investors should keep good records in the event they are audited in order to prevent any invalidation of an attempted 1031 exchange.

James G. Dibbini & Associates, P.C. is experienced in handling 1031 exchanges, for vacations homes and all types of commercial properties. We assist our clients with the execution of all 1031 exchange forms and guide each client through the necessary steps to complete the 1031 exchange. For legal representation of sellers or buyers or for more information regarding 1031 exchanges, please do not hesitate to contact our office.

Disclaimer: The information provided is not intended to be legal advice, but merely conveys general information related to legal issues commonly encountered.

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