

PLR 8103117 and Rev. Proc. 2008-16

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In science, one tests the rules of math, physics or biology to confirm the physical principles by which we live. If a rock slips from the roof of one's investment property, it falls to the ground every time to confirm a physical principle, gravity. Notwithstanding IRS regulations. We can learn about physical principles as well as legal principles by re-addressing past experiences and precedent.

Unfortunately, we do not have the same luxury with Private Letter Rulings. A PLR, under the rules of the IRS, applies to a private party requesting a ruling for a specific circumstance. PLR's do not provide absolute value to defend a similar fact situation from a challenge by the Internal Revenue Service.

We can, however, glean some guidance from PLRs as to how the IRS would view particular fact situations that have addressed many times previously such as with PLR 8103117. This PLR was decided on October 27, 1980. It has become common practice to refer to PLR 8103117 when determining whether or not vacation homes qualify for deferral treatment under IRC Sec. 1031.

In PLR 8103117, the taxpayer purchased a house and lot that he never used as a principal residence. It was held by the taxpayer for 17 years, rented occasionally during the first decade, and then the taxpayer resided there for approximately 10 days each year while the property was being refurbished. In its Private Letter Ruling the IRS determined this property qualified for exchange treatment under Sec. 1031(a).

Looking to this ruling for precedent, a vacation home will not qualify as "held for investment" under IRC Sec. 1031(a) if there is personal use much greater than 10 days each year. If there is minimal personal use of a vacation home and it is rented, it should qualify as "held for investment." Simply owning the vacation home for future use or future appreciation would probably be ruled as "held for investment" as long as there is minimal or no personal use.

Industry practice has led to the rule of thumb: If one resides in one's investment/vacation home fewer than 14 days per year, or less than 10% of the time it is rented, it will probably qualify for exchange treatment under Sec. 1031(a). Therefore, if one rents an investment/vacation home for 300 or more days a year, theoretically, one could reside in the home for 30 days each year.

On February 15, 2008, the IRS released Rev. Proc. 2008-16 that essentially codifies the rule of thumb. The purpose is to provide a "Safe Harbor," where the taxpayer will not be challenged as to whether or not a dwelling unit qualifies as property held for productive use in a trade or business or for investment purposes.

All exchanges of dwelling units occurring on or after March 10, 2008 will benefit from the Safe Harbor, if the qualifying use standards are met. Those standards for a relinquished property are 1. Qualifying Use

Period – the taxpayer has owned the dwelling unit for at least 24 months prior to the exchange. 2. The taxpayer rents the property to another person or persons for fair market rent for more than 14 days in each calendar year. 3. The taxpayer’s personal use does not exceed 14 days or 10 percent of the number of days the property is rented. These same standards apply to the replacement property as well.

This Safe Harbor only applies to whether or not a dwelling unit qualifies as property held for productive use in a trade or business. It is still up to the taxpayer to satisfy all other requirements under the regulations for a proper like-kind exchange. So any dwelling unit may qualify for an exchange as long as it was rented out to an unrelated person for 14 days in each of the last two years.

There may be fact circumstances outside the Safe Harbor that qualify for exchange treatment. Clearly, a vacation home is not going to qualify as “held for investment” under IRC Sec. 1031(a) if there is personal use that is excessive. Simply owning the vacation home for future use or future appreciation, would qualify as long as there is minimal or no personal use, but the IRS has given us a fixed standard in Rev. Proc. 2008-16.

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