

VACATION HOME EXCHANGES

"BARRY E. MOORE V. COMM., T.C. MEMO. 2007-134"



Compliments of

Many sellers who own vacation homes want to explore the potential of performing an Internal Revenue Code (IRC) Section 1031 tax deferred exchange. See Asset Preservation's handout entitled, "Vacation Home Exchanges - Basics", for an introduction to issues involved in these types of exchanges. One Tax Court decision, *Barry E. Moore v. Commissioner*, T.C. Memo. 2007-134, provides a significant case concerning whether a vacation home would be considered "held for investment." The court's analysis also indicates certain tax planning strategies investors may wish to use when considering exchanging a vacation home held for investment.

LAKEFRONT PROPERTY EXCHANGED FOR LAKEFRONT PROPERTY

In *Moore v. Comm.*, the taxpayers exchanged a lakefront vacation property with a mobile home in Lincoln County, Georgia (the Clark Hill property) for a lakefront property with a larger five bedroom and 4.5 bath house on 1.2 acres in Forsyth County, Georgia (the Lake Lanier property). The taxpayers in this case argued that both of these properties were held for investment, specifically for long-term appreciation purposes, and thus qualified for tax deferral under IRC §1031. However, based upon the taxpayer's significant personal use of the property, the court concluded that both the relinquished Clark Hill property and the replacement Lake Lanier property should be viewed as held primarily for the taxpayer's personal use and enjoyment. In reaching this conclusion, the court considered the following: (i) the taxpayers never rented or attempted to rent the property to others; (ii) the taxpayers deducted mortgage interest as a "home mortgage interest" expense rather than investment interest expense; (iii) the taxpayers did not take (and probably did not qualify for) depreciation or other tax benefits associated with an investment property under the Internal Revenue Code, including deductions for maintenance expenses.

The court accepted the taxpayer's argument that both the relinquished and replacement properties were held for appreciation but concluded that *"...the mere hope or expectation that the property may be sold at a gain cannot establish investment intent if the taxpayer uses the property as a residence. The proposition that holding a primary or secondary (e.g. vacation) residence motivated in part by an expectation that the property will appreciate in value is insufficient to justify the classification of that property as property 'held for investment' under Section 212(2) and, by analogy, Section 1031. There is no convincing evidence that the properties were held for the production of income, and there is convincing evidence that petitioners and their families used the properties as vacation retreats. The evidence overwhelmingly demonstrates that petitioners' primary purpose in acquiring both the Clark Hill and Lake Lanier properties was to enjoy the use of those properties as vacation homes, i.e. as secondary personal residences."*

ISSUES TO CONSIDER WHEN CONTEMPLATING A VACATION HOME EXCHANGE

Has the property been shown on one or more tax returns as an investment property or property used in a trade or business, including the characterization of mortgage interest as deductible investment interest expense or business expense? Is the improved property eligible for depreciation? Is the property used substantially as a personal vacation or second home? The characterization of residential property as held primarily for investment or for use in a trade or business is often unclear and must be made with reference to the taxpayer's use of the potential exchange property. Based on recent IRS announcements, we expect to see greater scrutiny of reported tax deferred exchanges under Section 1031. Accordingly, consult your legal or tax advisor before engaging in a tax deferred exchange.



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