



HOW LONG TO HOLD “Investor vs. Dealer Issues in IRS §1031”

Given our current real estate environment with shorts sales and REOs, it is not uncommon for those investors who are purchasing these products to turn around and sell them within a short period of time. As the profits grow, so does the tax liability, therefore these investors are seeking refuge in IRS Section 1031. But do they qualify?

Internal Revenue Code §1031 states that property “held for productive use in a trade or business or for investment” may be exchanged for like-kind property. There is much confusion and misinformation among real estate investors on what the phrase “held for investment” means. The question we often get is “how long do I need to hold my property to qualify?” As explained below, the question how long is really not the right question.

A MORE COMPLETE PERSPECTIVE

There is no holding period specified in the tax law after which property will qualify as “held for investment.” To qualify, an exchanger must have the intent to hold for investment. Intent is a subjective thing, so the IRS will look to objective factors that evidence the purpose for which property is held. Time is only one factor that may be considered in assessing the exchanger’s intent. Many other factors (in fact, “all facts and circumstances”) surrounding the taxpayer’s ownership and transfer of property may be considered in determining the taxpayer’s intent. Ideally, an exchanger could point to multiple factors to establish that the property is held for investment, such as a long period of ownership, a use consistent with an investment intent and a tax reporting history that demonstrates the investment use of the property.

Contrary facts, such as a sale of the property for a profit within a short period following the exchanger’s acquisition of the property may lead the IRS to conclude that the purpose of the original acquisition was to sell for a profit rather than to hold for investment. In that case, an exchange transaction would likely fail to qualify for tax deferral. Please see [Property Held for Sale](#) on our website to review more of the factors the IRS might examine to determine whether property is being held primarily for investment versus for sale.

SOME ADDITIONAL PERSPECTIVES

In one private letter ruling (PLR 8429039), the IRS stated that a minimum holding period of two years would be

sufficient. Although a private letter ruling does not establish legal precedent that can be relied on by anyone other than the recipient of the letter, many tax and legal advisors believe that a two year holding period is good evidence of an intent to hold in the absence of contrary facts (such as a continuous effort to sell the property during the two year holding period). Revenue Procedure 2008-16, which created a safe harbor for an exchange involving certain kinds of personal use or vacation property, specifies a “qualifying use period” or holding period of two years if the exchanger desires comfort that the IRS will not challenge the exchanger’s intent to hold for investment.

Other tax and legal advisors recommend that exchangers hold property for a minimum of at least twelve months. The reason for this is twofold: (1) a holding period of 12 or more months means the exchanger will reflect the investment property in two tax filing years and (2) In 1989, Congress had proposed a one year holding period. Although this proposal was never incorporated into the tax code, some advisors believe it represents a reasonable minimum guideline.

Every exchanger should also be aware that they will have to disclose to the IRS the amount of time they held the relinquished property when they file Form 8824 (Like-Kind Exchanges) along with their tax return. As discussed, the exchanger’s intent in holding both the relinquished and replacement property is the central issue. Each exchanger and their advisors should be able to substantiate that both the property relinquished and acquired in a [§1031 exchange](#) were held for investment.

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