

"HELD FOR INVESTMENT" - WHAT'S THAT?

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The actual wording of Internal Revenue Code §1031 says that in order to qualify for tax-deferred treatment, the property owner must sell property that has been "**held for** productive use in a trade or business or for **investment**" (*emphasis added*) and purchase property of like-kind. Often, potential exchangers want to know how long they have to own property to establish that it has been "held for investment." Unfortunately (or perhaps fortunately), neither the IRS nor the Regulations gives us a complete answer on that subject. If some specific time frame were established, it would certainly be an easier question to answer. On the other hand, if there were a specific time frame prescribed, the exchanger would have no possibility of building a case for the disposition of property held for less than the prescribed amount of time. So, although not setting out an exact period of ownership required creates some uncertainty, if it can be established that the property was indeed held for investment, the current state of no guidance actually provides greater latitude to the potential exchanger.

ESTABLISHING INTENT

So what's the investor supposed to do? If the investor believes, for whatever reason, that **an opportunity to sell the property early in the holding period may arise**, he would be wise to take some actions to establish that his intent upon purchase was to hold the property, not sell it. Want an example? Let's say the investor purchased a nice single-family home with the intention of keeping it as a rental property. He rents the home to a family moving from out of town. They live there for four months and decide that they love the home and ask about buying it. Can you imagine that happening?

So at the outset, with the intention of holding the property for investment, the investor takes appropriate actions: He holds the property out for rent to the open market. He runs ads in the local paper. He places the property on Craigslist and other online services. He distributes flyers to local places of business. He maintains the property in a manner consistent with preserving his investment. He essentially treats the property as the investment that it is. By keeping copies of ads, records of actions taken, and the like, the intent to hold the property as an investment can be verified if questioned in the future. And **if an opportunity to sell that he cannot pass up happens to arise after a short period of ownership, he can sell with the knowledge that he has made every attempt to establish his intention to hold the property as an investment.** There is no guarantee that the IRS agent on the other side of the table will agree with him, but he stands an infinitely greater chance of success with some documentation on his side than without.

WHAT IF INTENT IS DIFFICULT TO ESTABLISH?

Now let's assume that our investor friend did not keep copies of ads and records of activities relating to preserving the investment intent for the property. (Arguably, in this day and age, this discussion may be moot, what with the availability of archived newspapers online, handheld appointment schedulers and record keeping, etc., but let's assume the worst.) **In the exchange industry, it is pretty widely accepted that ownership for a period of two years should qualify for tax-deferred treatment. A one year period of ownership is less accepted, but still fairly widely believed to be adequate. A somewhat less widely accepted notion is that a holding period encompassing two tax years may satisfy the IRS, given other factors that also support investment intent. Theoretically, that could involve an extremely short period of ownership (Dec. 27 to Jan. 4, for instance, for the calendar year taxpayer). However, I would not advise trying this unless the investor believes strongly that he would prevail and is willing to put up a vigorous defense, because it would almost certainly be challenged.**

The **key factor**, if you haven't picked up on it already, is the **INTENT** of the investor at the time of purchasing the property. If the intent was to hold the property for investment, and if it can be adequately substantiated, let's get the exchange paperwork started.



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