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New Legislation Imposes a 5-Year Holding Requirement for Principals Residences Formerly Held as Investment Property

As many investors are aware, property acquired in an IRC §1031 exchange may be converted from investment property to the taxpayer's principal residence. In short, a taxpayer could buy property in an exchange—having deferred gain from the sale of other investment property—and later convert that property to a principal residence. The previously deferred taxes may never be owed when the property is subsequently sold because the taxpayer is entitled to a principal residence exclusion under IRC §121.

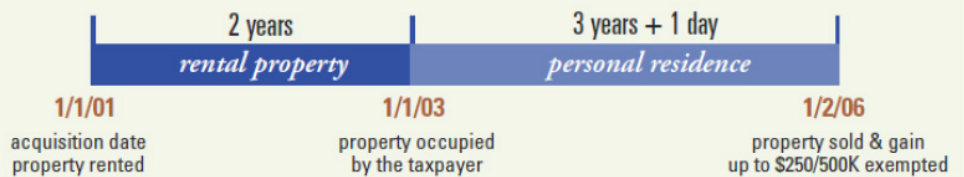
IRC §121 provides a taxpayer with an exemption from taxes on the gain from the sale of the taxpayer's principal residence if the taxpayer used the property as a principal residence for periods aggregating 2 years or more within the previous 5 years. The gain excluded from the payment of tax is \$250,000 for individuals or \$500,000 for married couples.

The new legislation—H.R.4520—provides, in pertinent part, as follows:

If a taxpayer acquired property in an exchange to which a §1031 applied, §121(a) shall not apply to the sale or exchange of such property if it occurs during the 5-year period beginning with the date of the acquisition of such property.

Now, pursuant to this new legislation, a taxpayer intending to take advantage of the §121 exclusion with regard to property originally acquired in a §1031 exchange, will not be entitled to the §121 exclusion, unless the property has been held by the taxpayer for more than 5 years and used as the taxpayer's principal residence for at least 2 of the 5 years.

Example of New Rule: 5 years and 1 day



Example of Old Rule: 4 years

