



Toll Free 888-899-1031  
Fax 303-715-1012

[infox@1031x.net](mailto:infox@1031x.net)

## Principal Residence VS. Investment Property in a 1031 Exchange

While many people consider their home (principal residence) to be an investment, the IRS does not. Instead, the IRS draws a distinction between real estate held for investment and real estate held as principal residence. The tax treatment of this characterization is very different. Generally, investments can be exchanged under IRC section 1031 while principal residences can be sold under IRC section 121. It might appear to be an easy task to determine what property is held for investment and what property is used for principal residence but consider the following recent tax authorities. A taxpayer moved out of his principal residence and rented it out. At the same time, he put the house on the market and tried to sell it.

The IRS ruled that this did not convert the property to investment property. Beware of this when attempting to convert a principal residence to investment property. In another case, the taxpayer sold the real estate (39 acres) on which his house trailer sat. He maintained ownership of the trailer and continued to live in the trailer on the property. The IRS ruled that the sale of land is not the sale of a principal residence. This ruling can lead to some creative tax planning. As you can see, it is not always easy to determine when section 1031 treatment is available on a property.

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