

# Intent to Hold for Investment

## Lessons Learned from Goolsby V. Commissioner

1031

Knowledge

A taxpayer's intent to hold both the relinquished property and replacement property for investment or for use in a trade or business is a requirement for any exchange transaction qualifying for tax deferral under Internal Revenue Code Section 1031. The IRS and federal courts may examine all of the facts and circumstances surrounding the transaction to determine the taxpayer's true intent at the time of the exchange. If those facts and circumstances are not consistent with the requisite intent, the exchange may not qualify for tax deferral. A *Goolsby* Tax Court case illustrates this point.

In *Goolsby v. Commissioner (April 1, 2010); T.C. Memo. 2010-64*, the taxpayers exchanged a relinquished property in California for two replacement properties located in Georgia. Two months after the exchange was completed, the taxpayers moved into one of the replacement properties (the Pebble Beach property) and used it as their personal residence. The IRS took the position that the Pebble Beach residence was not acquired with the requisite intent to hold for investment and failed to qualify as replacement property within the meaning of Section 1031(a). The Tax Court rejected the taxpayers' argument that certain other facts demonstrated that they intended to rent the property when they acquired it and decided later to move into the property. As a result, the taxpayers were liable for the capital gain taxes allocable to that portion of their exchange and also for an accuracy-related penalty for understatement of tax. In rejecting the taxpayers' argument, the Tax Court found that the Goolsbys:

- Conditioned the purchase of the Pebble Beach property on the sale of their former primary residence in California;
- Asked their qualified intermediary (QI) about converting an investment property into a residence before the exchange was completed;
- Failed to research whether the covenants of the homeowner's association would permit the Pebble Beach property to be used as a rental and generally did little research on the rental market;
- Placed a rental advertisement in a small neighborhood newspaper for only two months and made no other efforts to rent the property;
- Began preparations to finish the basement of the Pebble Beach property within two weeks after purchasing the property.

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Based upon these facts, the Tax Court concluded the taxpayers intended to move into the Pebble Beach property and lacked the intent to hold for investment at the time of acquisition. Other cases illustrate the importance of establishing the taxpayer's intent to hold for investment at the time of the exchange and that the taxpayer bears the responsibility of proving it. See e.g., *Bolker v. Commissioner*, 81 T.C. 782, 804 (1983), affd. 760 F.2d 1039 (9th Cir. 1985) and *Click v. Commissioner*, 78 T.C. 225, 231 (1982). Additionally, as seen in *Moore v. Commissioner*, T.C. Memo. 2007-134, the taxpayer's principal motivation must be to hold the property for investment purposes (e.g. rental income), rather than as a residence or for other personal use. In the end, the lessons of the *Goolsby* case are:

1. Taxpayer should make significant efforts to use the property acquired in a 1031 exchange as an investment property or in the taxpayer's trade or business before later converting the replacement property into a personal residence or into another non-qualifying use.
2. The IRS and the Tax Court will look at all objective evidence surrounding the acquisition to determine whether the taxpayer's use of the replacement property after the exchange is consistent with an investment or trade or business intent.
3. Any non-privileged discussions evidencing a contrary intent before, during, or after the exchange are fair game for the IRS, even the taxpayer's discussions with a qualified intermediary.
4. There is no substitute for careful planning, including the development of facts and circumstances that would substantiate the taxpayer's objective intent to hold the replacement property for investment or for use in a trade or business.

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