

## RENTING OUT YOUR VACATION HOME: WHAT ARE THE TAX BREAKS?

Any dwelling you designate for vacation — a house, condominium, mobile home or houseboat — is a vacation home, as long as it has a sleeping area, kitchen and bathroom facilities. Renting out your property is not for everyone. For some, keeping tabs on a tenant is a hassle. However, if you are able to find a reliable tenant, a rental activity can have financial rewards.

### WHAT CAN YOU DEDUCT?

Deductible rental property expenses include cleaning and maintenance, homeowner's insurance, mortgage interest, repairs<sup>i</sup>, real estate taxes, utilities and depreciation.<sup>ii</sup> These rental deductions are subject to special rules, depending on whether you also live in your vacation home for any part of the year.

If you use your vacation property as a home and you rent it out for fewer than 15 days during the year, you cannot deduct any rental expenses. However, the rent you collect is excluded from your taxable income.

### PERSONAL USE OF YOUR VACATION HOME

If you personally use your vacation home for more than 14 days during the year, or more than 10 percent of the number of days you rent it out (whichever is greater), you are required to pro-rate your expenses based on the ratio of personal days versus rental days.

Here are some rules to help you determine the number of personal versus rental days:

- Personal days include days you allow friends or relatives to use the home for free, or for a price that is less than what's considered *Fair Rental Price*.
- Days in which the dwelling is unoccupied are neither personal nor rental days.
- Rental days do not include days your home was available for rent but vacant — a renter must actually occupy the home.
- If both you and a renter paying *Fair Rental Price* are in the home on the same day, it counts as a rental day.

- A day spent substantially repairing and improving your home does not count as a rental day.

- Days your rental property is used for charitable purposes (for example, you permit a church group to use the home for a week) count as personal days.<sup>iii</sup>

**“Renting your vacation home to a reliable tenant not only provides you with extra income; it also means more of your personal expenses become tax deductible.”**

— Jackie Perlman,  
CPA, Senior Tax  
Research Analyst

### PRO-RATING YOUR EXPENSES

The following examples illustrate how to pro-rate between personal and rental days.

**EXAMPLE:** Mr. & Mrs. Warren have a beach cottage that they use from Jan. 1 through April 30 and again

from Nov. 1 through the end of the year. Their son uses the cottage rent free from May 1 through June 13. From July 1 through Sept. 28, they rent the cottage at the *Fair Rental Price* of \$1,000 a week.

This adds us to 90 days of rental use and 225 days of personal use. (Remember that the days

when the cottage is unoccupied do not count as personal or rental use, and the son's free use of the cottage is considered personal use for the Warrens.) Therefore, rental expenses are multiplied by 90/225 to determine the deductible portion.

The Warren's expenses include: \$1,200 for cleaning, \$5,000 for insurance, \$4,500 for mortgage insurance, \$2,000 in repairs, \$3,000 in real estate taxes and \$1,800 in utilities. Their depreciation expense is \$7,200, for a total of \$24,700 in expenses. To determine the deductible portion of the expenses, they multiply \$24,700 \_ 90/225. The total portion they can deduct is \$9,880.

From renting their cottage for 13 weeks, the Warrens will have additional income of \$13,000 (\$1,000 rent \_ 13 weeks), but their additional taxable income will be considerably less, due to the rental deductions. The additional taxable income will be \$3,120 (\$13,000 - \$9,880).

Additionally, the Warrens can deduct the remaining personal portion of some expenses as personal deductions. This includes the remaining real estate taxes and (if the cottage is considered their second home) the remaining mortgage interest.

## WHAT IF YOU HAVE LOSSES?

What if your rental expenses *exceed* your rental income?

You may deduct losses up to \$25,000 if you *actively participate* in the rental activity and your adjusted gross income for the year is \$100,000 or less. *Active participation* means that you make all management decisions about the property, collect the rent and do the repairs, etc. The IRS looks at the circumstances for each rental activity to decide whether active participation exists.

<sup>1</sup> Capital improvements, such as a new roof or sidewalks, add to the basis of the home. These items may be depreciated over time rather than expensed outright.

<sup>2</sup> Both the dwelling itself and furnishings are subject to depreciation. See IRS Publication 527 *Residential Rental Property* on how to calculate the depreciation deduction.

<sup>3</sup> NOTE: Allowing your property to be used by a charitable organization does *not* qualify as a charitable contribution deduction.