

Abstract: What are the tax implications when a taxpayer who owns a vacation home rents it out? The answer depends on various factors, such as the amount of time rented out and the number of days used by the owner. The calculation of taxable income can be complex. This article explains.

Renting out your vacation home? Know the tax implications

If you're fortunate enough to own a vacation home, you may want to rent it out when you're not using it. But how might that affect your taxes?

The answer lies in keeping good records. Before you post the "for rent" sign, consider how many days you, your relatives (even if they pay market rent) and nonrelatives use the home if market rent isn't charged.

Under 15 days

In the right circumstances, renting the property out can produce revenue and significant tax benefits. If the property is rented out for less than 15 days during the year, it's not treated as "rental property," and the rent you collect isn't included in your taxable income at all. On the other hand, you can only deduct (as itemized deductions) property taxes and mortgage interest — no other operating costs or depreciation. (Mortgage interest is deductible on your principal residence and one other home, subject to certain limits.)

If you rent the property out for more than 14 days, you must include the rent received in income. However, you can deduct part of your operating expenses and depreciation, subject to certain rules. First, you must allocate your expenses between the personal use days and the rental days. For example, if the house is rented for 90 days and used personally for 30 days, 75% of the use is rental (90 out of 120 total use days).

You may allocate to rental 75% of your costs such as maintenance, utilities and insurance, plus 75% of your depreciation allowance, interest and taxes for the property. The personal use portion of taxes is separately deductible as an itemized deduction. The personal use part of interest on a second home is also deductible (if eligible) where the personal use exceeds the greater of 14 days or 10% of the rental days. However, depreciation on the personal use portion isn't allowed.

Claiming a loss

If the expenses exceed the income, you may be able to claim a rental loss (subject to the passive activity rules), depending on how many days you use the house for personal purposes. Here's the test: If you use it personally for more than the greater of 14 days or 10% of the rental days, you're using it "too much" and can't claim your loss. In this case, you can still use your deductions to wipe out rental income, but you can't create a loss. Deductions you can't use are carried forward and may be usable in future years. If you're limited to using deductions only up

to the rental income amount, you must use the deductions allocated to the rental portion in this order: 1) interest and taxes, 2) operating costs 3) depreciation.

If you “pass” the personal use test, you must still allocate your expenses between the personal and rental portions. In this case, however, if your rental deductions exceed rental income, you can claim the loss. (The loss is “passive” and may be limited under passive loss rules.)

Planning ahead

These are the basic rules. There may be other rules if you’re considered a small landlord or real estate professional. Contact us if you have questions. We can help plan your vacation home use to achieve optimal tax results.

© 2022