



## Tax Rules for Renting a Vacation Home

The summer is winding down so we thought this would be a good time to take a look at the tax rules related to vacation home rentals.

Vacation homeowners may choose to rent out their properties to offset the expenses of ownership or to generate income. As a result, vacation homeowners could be entitled to certain tax benefits that may help make their vacation home more affordable.

Nevertheless, these tax breaks are dependent on meeting several requirements, including the number of days each year that the property is rented out.

By understanding the tax rules ahead of time, vacation homeowners can take advantage of tax breaks and avoid costly surprises at tax time.

If a homeowner gets paid rental income, the income is taxed by the IRS. However, the homeowner can usually deduct certain expenses. The total amount of the expenses reduces the taxable rental income for the owner. Vacation homeowners have specific tax rules that must be followed in order for the owner to be able to deduct expenses related to the rental property.

### The 14-Day or 10% Rule

The tax benefits to which an owner may be entitled depends upon the number of days each year that the property is rented out, and how much time the owner spends in the home.

If the vacation home is used exclusively for the owner's personal enjoyment (and it is not rented out at any time during the year), the owner can generally deduct real estate taxes and interest on a home mortgage. As with a primary residence, the costs associated with insurance, maintenance, and utilities cannot be written off.

If the home **IS** used for rental purposes, the homeowner will fall into one of three categories:

#### 1. Property Used as a Home and Rented less than 15 Days

Per IRS rules, a vacation property can be rented out for up to two weeks (14 nights) each year without the need to report the rental income. In this case, the house is still considered a **personal residence**, so the owner can deduct mortgage interest and property taxes on a Schedule A under the standard second home rules. However, the owner cannot deduct any expenses as rental expenses.

This tax break is sometimes called the "Masters exemption" since homeowners close to the Augusta National Golf Club can earn as much as \$20,000 renting out their homes during the annual tournament without having to report the income on their tax returns!

## 2. Property Rented 15 Days or More and Used for 14 Days or Less

In this case, the property is considered **arental property**, and the rental activities are viewed as a **business**. All rental income must be reported to the IRS, and the owner can deduct certain rental expenses, including the following:

- Fees paid to property managers
- Insurance premiums
- Maintenance expenses
- Mortgage Interest
- Property taxes
- Utilities
- Depreciation

The amount of rental expenses that can be deducted is based on the percentage of days that the vacation home was rented out, called "rental days." The deductible expenses are calculated by dividing the number of days the home was rented out by the total number of days the home was used: rental days plus personal use days.

As an example, if a vacation home had 99 total days of use, and 85 of those days were rental days, 86% of the expenses (85 rental days/99 total days of use) can be deducted against the rental income. The rental portion of the expenses in excess of the rental income cannot be deducted. The owner would not be able to deduct the remaining 14% of the rental expenses.

In addition to deducting rental expenses, owners may be able to deduct up to \$25,000 each year in losses, depending on the adjusted gross income (AGI) of the owner. Such "passive losses" can be written off if the owner manages the property themselves. A passive loss is a loss that cannot be deducted if the taxpayer does not materially participate in the rental property. However, the IRS provides this special exception for smaller property owners.

## 3. The Owner Uses the Property for More than 14 Days or 10% of the Total Days the Home Was Rented -

If personal days exceed 14 days or 10% of the number of days the home is rented —whichever is greater—the IRS considers the property a **personal residence** and rental loss cannot be deducted. Rental expenses, up to the level of rental income, as well as property taxes and mortgage interest, can still be deducted.

Since the 14-day cutoff can have a dramatic effect on taxes, it's important to track and document personal use days versus days used for repairs and maintenance.

According to the IRS: Any day that you spend working substantially full time repairing and maintaining (not improving) your property isn't counted as a day of personal use. Don't count such a day as a day of personal use even if family members use the property for recreational purposes on the same day.

Since tax laws in this area can be complex, it may be helpful to consult with a qualified tax specialist to gain a comprehensive understanding of the tax laws and to determine the best approach to renting out your vacation home.

**This alert covers only some of the tax rules related to renting a vacation home that could potentially benefit you, your family and your business. Please contact us if you have questions, want more information, or would like us to help you with a specific home rental situation, so that by working together we can deliver the best tax results for you.**

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