

The Tax Treatment of Owning a Vacation Home

The taxpayer who owns a vacation home falls into one of four categories:

Category	Second Home Use	
	Personal	Rental
I	Exclusive	-
II	-	Exclusive
III	Primary	Limited
IV	Limited	Primary

Federal tax treatment of each category:

I. Second home used strictly as a vacation home

1. Taxpayer may deduct property taxes and mortgage interest by itemizing on Schedule A of the tax return.
2. Taxpayer may not deduct operating losses, repair expenses, or depreciation.
3. For tax purposes, the taxpayer may only have one second home.

II. Second home used strictly as a rental property

1. Most second homeowners fall into this category.
2. The taxpayer is in the second category if:
 - a. The second home is rented and
 - b. The homeowner does not personally use the home on an annual basis more than 14 days or 10% of the total time rented.
3. Personal use as defined by the IRS includes:
 - a. Days or parts of days the owner or owner's family uses the home.
 - b. Days when the property is used by a relative.
4. Personal use does not include:
 - a. Days spent maintaining the home.
 - b. Days spent preparing the home for summer rental.
 - c. Days spent closing the home for winter.
5. All income and expenses associated with renting the property, including depreciation, are deductible on Schedule E of the tax return.
6. Any losses incurred on the rental of a second home are subject to the passive losses rules established by the Tax Reform Act of 1986.
 - a. The losses are available only if the taxpayer "actively participates" in managing the rental property. For example, establishing rental terms or arranging for others to provide maintenance and repair services to the rental property meets the "active participation" test.
 - b. The passive loss rules provide that a taxpayer may take up to \$25,000 in rental or passive losses if adjusted gross income does not exceed \$100,000.
 - c. If the taxpayer's adjusted gross income is more than \$100,000 then the amount that may be deducted is reduced by \$1 for every \$2 above \$100,000.
 - d. If the taxpayer's adjusted gross income is more than \$150,000 then the rental losses are disallowed entirely for that year, although they may be carried forward to offset future rental or passive income.
 - e. Taxpayers with adjusted gross income over \$150,000 can avoid the passive loss limitations by either netting the passive losses against other passive income or by treating the home as a second residence so that the taxpayer may still deduct property taxes and all mortgage interest on Schedule A of the tax return.

cont.

III. Second home used primarily as a vacation home

1. If the home is rented for fewer than 15 days, the rental income does not have to be reported and the owner may deduct property taxes and mortgage interest on Schedule A of the tax return.

IV. Second home used primarily as a rental property

1. The taxpayer is in the fourth category if the second home is used personally on an annual basis more than 14 days or 10% of the total number of days the home is rented.
2. Expenses and other deductible items must be allocated according to the number of days the property is rented versus the number of days it is used personally.
 - a. The proration of personal property taxes and mortgage interest associated with the personal use is deducted or itemized on Schedule A of the tax return.
 - b. The rental income and the proration of personal property taxes, mortgage interest, depreciation, and other expenses associated with the rental use are reported on schedule E of the tax return.
3. The passive loss rules do not apply to the rental use so that losses on the rental portion are not deductible but they may be carried forward to offset future rental income.

*Please consult with your tax advisor
regarding how these tax benefits could affect you personally.*

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