

Wright Ford Young & Co.

Certified Public Accountants and Consultants, Inc.

Losses on Residential Rental Properties and the Deductibility of Those Losses

Dear Client & Friends:

Tax reporting on the rental of a taxpayer's residence or vacation home depends on how many days the property is used for rental purposes as opposed to personal purposes. A *residence* or *dwelling* is defined as a dwelling unit and includes a house, apartment, condominium, mobile home, boat, or similar property. Residences used personally by the taxpayer generally fall into one of three categories when determining their tax treatment.

1. *Personal Residence with Very Limited Rental Use* - A residence that is rented for fewer than 15 days during the year.
2. *Vacation Home with Both Rental and Personal Use* - Property with (a) personal use that exceeds the greater of 14 days or 10% of rental days and (b) rental use that exceeds 14 days.
3. *Rental Property with Very Limited Personal Use* - Property rented during the year and personal use that does not exceed the greater of 14 days or 10% of rental days.

The property's designation for tax purposes can change yearly, depending on how the property is used. The property's designation also impacts treatment for sale of the property.

Personal Residence with Very Limited Rental Use If such residence is rented for fewer than 15 days during the calendar year, it is considered solely a personal residence. The taxpayer is not entitled to a special deduction for any expenses associated with the rental of the property other than mortgage interest and property taxes, and any income received from the rental use is not taxable.

Vacation Home with Both Rental and Personal Use If property used as a residence is rented more than 14 days, deductions (other than interest, taxes, and casualty losses) are limited to the amount of the income from the property.

Rental Property with Very Limited Personal Use If the taxpayer's dwelling is rented during the tax year and personal use does not exceed the greater of (1) 14 days, or (2) 10% of rental days, it is not considered a residence. Instead, it is considered a rental property.

Rental activities generally fall into the category of "passive" activities. This means that rental losses you incur can be deducted currently only against passive income from other rental properties for example and not against nonpassive income, such as your wages or investment income.

However, if you "actively participate" in the residential rental activity and your adjusted gross income is less than \$150,000, you may be able to deduct a loss of up to \$25,000 in a tax year against nonpassive income. You actively participate in the rental activity if you make key management decisions, such as approving new tenants, deciding on rental terms, approving capital expenditures. You also can show active participation by arranging for others to provide services. You need not have regular, continuous, and substantial involvement with the property. Also, be sure to keep good records showing rental days and personal use days.

Losses that aren't allowed because of the amount limitations don't just disappear. They are carried forward and can be deducted against nonpassive income in future years if you continue to actively participate in the rental real estate activity that generated the losses, subject to the \$25,000 limit.

The tax treatment of a rental property or a vacation home is not straight-forward and requires careful analysis and planning. Please schedule an appointment with us to discuss the proper treatment and deductibility of losses from your rental or vacation home properties.

Very truly yours,

Wright Ford Young & Co.

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