

**"We either make ourselves miserable or we make ourselves strong. The amount of work is the same."**

*-- Carlos Castaneda, author*

Tax Tip – May 10, 2017

Real Estate

Part 2 of 2

Rental Investments

A rental activity in which the payment is for use of tangible property is generally “passive.” Losses from this type of activity can generally offset only gains from such activities, including profits from sales of the properties. Losses unusable this year can be carried forward to years when you have passive-activity income. The only other way to use suspended losses is to dispose of the entire activity. The depreciation period for nonresidential real property is 39 years for most property placed in service after May 12, 1993. That for residential rental property is 27½ years. (Note: income from a passive activity may be subject to the 3.8% Medicare surtax if you do not materially participate and you meet the AGI thresholds for the surtax.)

Exception: If you “actively” participate in renting real estate (i.e., you are at least a 10%-owner and deeply involved in its operation), you can currently deduct up to $25,000 of your net passive rental real estate losses. The deduction is reduced by $1 for every $2 of AGI in the phaseout range: $100,000-$150,000 (MFJ). The landlord must spend over half his or her time materially participating in realty and put in more than 750 hours per year to deduct losses.

Repairs to a rental property can be deducted for the year when made, but improvements must be depreciated over many years. To keep these types of work separate, do them at different times and get them billed separately, if possible by different contractors. If you convert to rental use a house that has lost value since you bought it, only the drop in value after the conversion will be deductible when you sell.

Vacation Homes

The tax details of owning a vacation home can be complex, so seek guidance from your tax advisor who can help you take advantage of potentially available benefits. The chart below outlines the basics.

There’s a restriction on a vacation home converted to a primary residence and later sold. A portion of the profit may be subject to tax, based on the time when the house was a second home or a rental to the total time you owned it.

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| --- | --- | --- |
| Rented Days Rental Income Deductions | | |
| Less than 15 per year | Tax Free | Mortgage Interest and property tax |
| 15 or more/yr. and personal use either less than 14 days or less than 10% of rented days | Must be included in income | Expenses and depreciation |

Home Offices

Home office expenses are potentially deductible if it’s your principal place of business for your most important business functions, where you meet with customers, or located in a separate structure on your property. It must be used regularly and exclusively for business. You cannot deduct more than the net income from the business. There are two methods for taking this deduction. Under the simplified method the deduction is capped at $1,500 ($5/sq. ft. up to 300 sq. ft.). Depreciation, allowable mortgage interest and real estate taxes are claimed as itemized deductions. Business expenses unrelated to the home office (e.g., supplies and advertising) remain deductible. Under the regular method, business expenses not related to the home office and the business portion of mortgage interest and real estate taxes are first deducted from income, then home-office expenses and depreciation on the business portion of your house are deducted. In a sale of your home, gain on the office part may be taxable and depreciation may have to be recaptured.

If you have any questions regarding this information, please feel free to contact our office.

P.S. Please forward this to your friends or colleagues that you'd like to introduce our firm to. Or send us their email address and we'll ask for their permission to forward with your compliments.

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