

O'Neil & Steiner, PLLC

Renting Part of your Primary Residence

The tax treatment of renting a portion of your primary residence (renting a room for example) depends on how many days it's rented and your level of personal use. Personal use includes use by you, your relatives (even if you charge them market rate rent, unless they are renting it as their main home) and by nonrelatives if a fair rental value is not charged. Rental use (opposite of personal use) includes being rented at fair market value, vacant for repairs/maintenance, and vacant while being advertised for rent.

If you rent the property out for **less than 15 days** during the year, it's not treated as "rental property" at all. In the right circumstances, this can produce significant tax benefits. Any rent you receive isn't included in your income for tax purposes (no matter how substantial the amount). On the other hand, you may be able to deduct property taxes and mortgage interest-no other operating costs and no depreciation. *Deductions for mortgage interest & property taxes are subject to limitations specific to your tax returns.

If you rent the property out for **more than 14 days**, you must include the rent you receive in income. However, you can deduct part of your operating expenses and depreciation, subject to the following rules.

In order to deduct related expenses, you must allocate your expenses between personal use and rental use.

The first step in the process is to determine the Percentage Rental Use. This step involves two factors: time and rented space.

The Time Factor is calculated by dividing days rented (or held vacant for repairs or while being advertised as available for rent) by 365. For example, if you rented a room for 100 days, the time factor would be 27.4% (100 days divided by 365 total days of use).

The Rented Space Factor is determined by comparing the rented space to your total home. This can be done by square footage (square footage of rented space divided by total square footage of your residence) or by the number of bedrooms (number of rooms rented divided by total number of bedrooms). For example, if you rented 25% of the square footage of your home (or rented one bedroom in a four bedroom home) your rented space would be 25%.

These two factors are then multiplied to determine your percentage of rental use. In the above example we considered having rented a bedroom that was 25% of the square footage of our home (or 1 of 4 bedrooms in the home) for 100 days.

Time Factor (27.4%) x Rented Space Factor (25%) = 6.85% is our Percentage of Rental Use.

Next, you must calculate your total expenses for the year separately for two categories:

1. Expenses related to the rental use of the property alone.
2. Expenses related to the whole residence.

O'Neil & Steiner, PLLC

Renting Part of your Primary Residence

Expenses related to the rental use of the property alone are costs you would not have paid for except for the room being rented. Examples of these include advertising the available space, increased insurance premiums for adding a "landlord policy" to your insurance coverage, repairs to the room being rented for rental use damages, having carpets cleaned between tenants, legal fees to draft rental agreement, etc. These expenses are fully deductible.

Expenses related to the whole residence include all other residence related expenses. Examples include utilities, homeowner's insurance, real estate taxes, mortgage interest, depreciation, etc. These expenses are multiplied by the Percentage of Rental Use to determine the deductible portion. The remaining portion of these expenses are allocated to personal use. In the above example, 6.85% of these expenses would be deductible from rental income.

The personal use portion of interest and real estate taxes paid may be claimed as itemized deductions (assuming your itemized deductions exceed the standard deduction). *Deductions for mortgage interest & property taxes are subject to limitations specific to your tax returns.

If the rental income exceeds these allocable deductions, then you report the rent and deductions to determine the amount of rental income to add to your other income. If the expenses exceed the income, you will have a passive loss. Passive losses are frozen unless/until you have passive income to be claimed. Passive income from future year rental activities or other sources of passive income would be reduced by passive losses in future years.

So as to avoid confusion, the Rental Organizer available on our website does not provide for renting a portion of your primary residence. Please call or email the office and we will provide you with a separate organizer to help you submit the necessary information to report this activity.

If you have additional questions or would like to discuss this subject further, please contact the front desk to schedule a consultation.