

## The ARTICLES



### VACATION HOMES & INTERNAL REVENUE CODE SECTION 280A

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The COVID-19 pandemic has increased the demand for vacation homes for reasons including seeking an alternative space for working remotely or just a place to get away from it all as an escape. Some of these purchasers may want to rent out the home as a way to help pay for it. Before a taxpayer purchases a home with the intent of leasing it, it is important to be aware of the tax ramifications.

#### Section 280A

Internal Revenue Code section 280A covers limitations on deductions with respect to a dwelling unit used by the taxpayer as a residence during the taxable year. A dwelling unit refers to a house, condominium, apartment, mobile home, boat or similar property with living space, toilet and cooking facilities. The term "dwelling unit" does not include hotel or motel rooms or similar establishments. Taxpayers covered by this code section include individuals, partnerships, trusts, estates and S-corporations.

A taxpayer is considered to have used a dwelling unit as a residence if, during the taxable year, the taxpayer uses the dwelling unit for personal purposes for the greater of 14 days or 10% of the number of days the unit is rented at fair market value.

Example: A owns a vacation home and uses it for personal purposes for 20 days during the taxable year. A rents the home at fair rental for 210 days during the year. Since A's use for personal purposes (20 days) is less than 10%

of the days the unit is rented (210 days), A is not considered to have used the vacation home as a residence for the taxable year.

There are attribution rules a taxpayer must consider when determining personal use of a dwelling unit. Examples include personal use by the taxpayer or any person who has an interest in the unit, such as by a brother or sister, spouse, parent or child. Personal use also includes instances where any individual uses the unit under a reciprocal arrangement where the taxpayer can use another property at less than fair value rental.

There are special rules for when an interest in a dwelling unit is owned by a partnership, trust, estate or S-corporation. These entities are referred to as pass-through entities, and any partner, beneficiary or shareholder is referred to as a beneficial owner.

A pass-through entity will be considered to have personal use of a dwelling unit if on any day a beneficial owner has personal use of the unit. For example, personal use by the brother of a fellow partner in a partnership is considered personal use by the partnership.

There is an exception when a dwelling unit is rented to a family member as a "principal" residence. Such family member will not be considered to use the dwelling unit for personal use, and section 280A will not apply. This exception also covers a partner renting a dwelling unit from a partnership as a "principal" residence.

There is also an exception for using the dwelling unit to perform repairs and maintenance. Whether or not the use of the dwelling unit is deemed to be for the purpose of maintenance will depend on facts and circumstances, including the time spent on the repairs and maintenance and the presence of companions while performing the maintenance.

Let's discuss how deductions are limited when a taxpayer's personal use of a dwelling unit as a residence causes 280A to apply.

#### Limitations on Deductibility

There is a gross income limitation on deductibility. Home rental expenses may only be deducted up to the amount of gross income. An expense allocation formula requires the taxpayer to allocate business and personal use based on number of days. This formula does not apply to qualified home mortgage interest and real estate taxes, which can be deducted as itemized deductions, subject to other limitations. There is a complicated four-tier system of deductions.

A bright point in the law is that if a vacation home is rented for less than 15 days during the tax year, the taxpayer is not allowed to deduct expenses in connection with the 15 days, but the corresponding rental income does not have to be reported.

Internal Revenue Code section 280A is somewhat complex. Taxpayers should be very careful in applying the rules to their own situation and consult their tax professional.