Dividing the Vacation Home, Personal Use Property or Investment Property;
Getting Away from the Getaway
By Sheila May, CPA

Many couples have a vacation home that they use for their personal use or as an investment (rental property). When divorcing, how it was used and how it will be used indicates the way to divide the vacation property.

PERSONAL USE VACTION PROPERTY –

SELLING THE PROPERTY

In order to determine how much gain or loss you'll have with the sale of the property, determine your basis in the property. Your basis is the amount of cash you paid for the property or the value of the mortgage you acquired to pay for the property. “What you paid” also includes the fair market value of any property or services you traded, the sales tax, the cost of any capital improvements, and any installation and testing charges. Capital improvements are those that increase the value of the property i.e. a new kitchen. The sale price minus the basis is the capital gain on which you will pay state and federal taxes. When dividing the rental property, the most obvious option is to decide how to share the proceeds (if any) net of taxes, prior to the execution of the sale.

KEEPING THE PROPERTY

At times, the easiest solution is for one spouse to make the vacation property their new permanent residence. For the division of assets equation, agree to a means of coming up with the vacation house’s Fair Market Value. Some people use the town’s assessment value, some use a real estate professional, and still others hire a special appraiser. The point is to agree how to agree. Remember the vacation home must be a permanent residence for at least two of the five years before you sell and you qualify for up to $500,000 of tax-free profit ($250,000 if single) on the sale.

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RENTAL -

SELLING THE PROPERTY

Again, you will need to determine your basis in the property and decide how to handle the proceeds. Your basis in a rental property can be found on Form 4562 line 19h. Of course, until the property sells there will have to be some agreement as to who pays the costs and receives the income.

KEEPING THE PROPERTY

Decide how much basis each of you has in the property. Basis also may help you to determine the amount of income you receive each year and will be used to determine the depreciation expense.

Rental Income: You and your ex-spouse must report the amount of gross income that you each receive from the rental property.

Rental expenses: You must deduct expenses proportional to the amount of income that you receive from the property, or that you personally incur, depending on how you decide to pay for them. Deductible expenses include insurance, advertising, maintenance and repairs, legal fees, taxes, mortgage interest and points, management fees, cleaning service fees, and travel and transportation fees to visit rental property or collect rent.

Depreciation: Using your basis in the property, figure out how much depreciation you're eligible to claim each year. You can't deduct more than your basis in the property. If you or your ex-spouse uses the property for personal use, then you cannot depreciate that portion of the property. There are other rules regarding personal use of rental properties. For example, if you used your rental property more than 14 days, or 10% of

the total days it is rented to others at a fair rental price you have used the property as a home and cannot deduct expenses incurred for those days as related to the rental property.

CONVERTING THE RENTAL PROPERTY TO A PRIMARY RESIDENCE

The tax implications of this option warrant some attention. If you decide that one of you should make your rental property your primary residence, the capital gains exclusion for the sale of the primary residence (the former rental property) will be complicated. The amount of gains that can be excluded is the gain multiplied by a fraction: the numerator as the number of years of qualified use (time the property served as the resident's primary residence) and the denominator being the number of years the resident owned the property. Further complicating the equation is that any years prior to 2009 do not count as non-qualified use period, but are taken into account for ownership period.

An example:

You buy a property in 2007 and rent it out for three years until 2010. In 2010, one of you makes the property your primary residence. In 2013, one of you sells the property for a $250,000 gain. The ownership period is six years. The qualified use period is five years because only 2009 – 2010 is considered non-qualified use. $250,000 X 1/6 or roughly $41,666.66 is ineligible for the capital gains on primary residence exclusion.