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Increasing the Value
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A Vacation Home: The Ultimate Hideaway

Are you dreaming of a mountain cabin or an oceanfront bungalow hideaway? Then you may want to consider that a vacation home can offer some tax savings. Whether you choose to use the home solely for enjoyment or combine business and pleasure by renting the property part-time, it is important to understand the tax laws for a second home.

As long as the combined debt secured by the vacation home and your principal residence does not exceed \$1.1 million, you can deduct all of the interest paid on a mortgage used to buy a second home. This advantage is restricted to two homes. Should you purchase a third home, interest on that mortgage is not deductible. However, regardless of how many homes you have, you may be able to deduct all of the property tax paid.

One break enjoyed by homeowners—the right to immediately deduct points paid on a mortgage—applies only to a principal residence. Points paid on a loan for a second home must be deducted gradually, as the mortgage is paid off.

Personal Residence

Your vacation home is considered a personal residence if you rent it for no more than 14 days a year. In such a situation, you may retain the rent tax free without jeopardizing your mortgage interest and tax deductions. However, you may not deduct any rental-related expenses. If you rent out the house on a continual basis, things may become more complicated. Depending on the breakdown between personal and rental use, different rules may apply.

If you buy primarily for pleasure but rent for 15 days or more, the rent you receive is taxable. Because the house is still considered a personal residence, you may deduct all of the interest and property tax. You may also be able to deduct other rental-related expenses, including the cost of utilities, repairs, and insurance attributable to the time the house is rented. In some cases, you may be able to deduct depreciation. When the house is considered a personal residence, rental deductions cannot exceed the amount of rental income you report. In other words, your second home cannot produce a tax loss to shelter other income. In most cases, the interest and taxes assigned to the rental use of the house combined with the operating expenses more than offset rental income, thus limiting your ability to write off depreciation.

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