

Renting Your Residence to Your Practice

Internal Revenue Code Section 280A of the tax law covers the tax treatment of income and expenses related to the business use of a personal residence and vacation home. Section 280A(g) provides for the possible tax-free income for rentals of fewer than 15 days.

The following special rule comes from IRS Code § 280A (g).

Special rule for certain rental use

Notwithstanding any other provision of this section or section 183, if a dwelling unit is used during the taxable year by the taxpayer as a residence and such dwelling unit is actually rented for less than 15 days during the taxable year, then—

- 1) no deduction otherwise allowable under this chapter because of the rental use of such dwelling unit shall be allowed, and
- 2) the income derived from such use for the taxable year shall not be included in the gross income of such taxpayer under section 61.

Under this rule, if a dentist rents out his residence or secondary residence for fewer than 15 days during the year, then none of the rental-related expenses will be treated as tax-deductible. This includes depreciation, utilities, repairs and maintenance, etc. Although at first glance this may seem like bad news, it is not, because under this code section, the rental income is tax-free. These rental days can be sporadic throughout the year or continuous, but the most important thing to remember is they cannot exceed 14 days throughout the entire calendar year.

In order to qualify, the residence must be used for personal purposes during the tax year for either more than 14 days or 10% of the days rented out, whichever is greater. This special tax break does not apply to business or investment property, but only to personal use residences.

If you can justify the use of one of your personal residences for business purposes, then you may be able to have your cake and eat it too. If you qualify, your dental practice will be able to deduct the fair market value of rent it pays to you personally as a business expense, and you would be able to personally receive this payment income-tax-free.

If you have plans in the future to rent out a conference room, catering hall, or hotel rooms for business use, you may be able to make the argument of renting out your home or vacation home to your dental practice as an alternative. You would, of course, have to be able to show that this is an ordinary and necessary expense in operating your dental practice.

So, for example, if you are planning to have a monthly staff meeting but do not have a conference room large enough in your office to accommodate this, you may be able to rent out space from your home residence to accommodate this meeting. If you are planning to have a 3-day employee retreat, rather than renting out hotel rooms for your staff, you can have this function at your vacation residence.

This strategy works if you are set up as a corporation or a partnership and are required to file Form 1120, 1120S, or 1065. It does *not* work for Schedule C dental practices that are set up as sole proprietorships or single-member LLCs. You must have a separate legal entity for tax purposes, and a sole proprietorship and single-member LLC does not meet this requirement.

The following are the steps you should follow in order to justify and properly document this deduction for your practice and tax-free income to yourself.

1. Does the rent constitute an **ordinary and necessary business expense** based on your specific practice situation?
2. You should plan and put in writing the **business purpose** for this rental. The IRS requires you to take minutes at corporate meetings, so be sure to do this. If it was for a business planning meeting, you should have the agenda, attendees, and notes from the meeting. The same is true for an employee retreat. This would be part of the required documentation.
3. You must determine a **fair rent** for the use of your residence. Determine a reasonable rent by reaching out to local hotels for the cost of their conference room or hotel rooms, whichever may apply. This would be part of the required documentation.
4. You must personally **submit an invoice** to your dental practice, just like any other renter would do under the circumstances. Be sure to include the date, the length of time, as well as the details of what was provided as part of the rental. If you include equipment usage, internet and cable access, coffee and snacks, or other items, be sure to include these items as part of the description of what was provided.
5. Your practice should then **write a check** to you for the fair market value of this rental usage. If your practice pays you more than \$600 for this rental use, you must report this to the IRS by **issuing yourself a Form 1099** in January.
6. You must **report this rental income on Schedule E** of Form 1040 of your personal income tax return. This income can then be offset with the line item under "other deductions" for the same amount reported as income. Please be sure to **describe this as "non-taxable income under IRS Code Section 280A(g)."** The net effect will be that you will report no taxable income from the rent you received from your practice.

If you have any questions about implementing this tax-saving strategy, please be sure to give us a call. It's important to know there are many rules and regulations that must be complied with to qualify, therefore you should not attempt to make this determination without the proper advice and guidance.