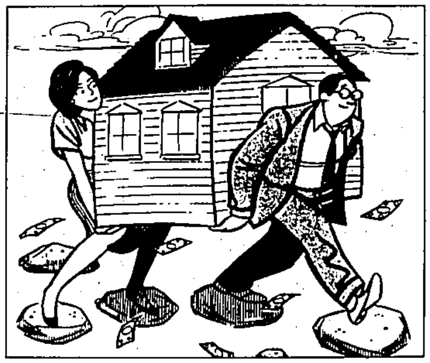
Rental of unsold house can trigger tax problems



(AP) — Many people with an unsold home feel that they are strapped with a financial and psychological albatross. If you're so afflicted, or worry that you may be because you plan to move soon — renting the old place temporarily may be your best option.

Make no mistake: It's far from an ideal solution. When you become a landlord, you're saddled with a whole new set of record-keeping and tax problems. You'll have to screen tenants. You'll still be stuck with all the responsibilities of ownership. And there's no guarantee prices will be better next year.

But renting can be a helpful interim step. Any rental income you receive eases the cash flow nightmare of having to support two mortgages. If your expenses exceed the rent you can command, you may qualify for a tax break.

Before tackling the landlording realities of setting the rent, finding tenants and writing a lease, consider the key tax issues you'll confront.

A major concern when you rent your house is to protect your right to roll over the profit and hold off the Internal Revenue Service. If you have owned a number of houses during your homeowning career and used the rollover provision repeatedly, the combined profit from several homes could be at stake. Losing the rollover right could cost you a fortune in taxes.

TO AVOID THAT, you have to sell the old house within two years of the time you buy a replacement home. (You may have as long as four years if you're on active duty with the armed forces.) As long as the new home costs as much as the amount you get from the sale of the old one, the rollover rules will protect you from a tax bill.

Another potential problem is that the rollover break applies only when you move from one principal residence to another. It doesn't apply when you sell a rental property. That means you must be able to show that converting your home is a temporary measure rather than a permanent switch. Proof that you're renting for the short term can include efforts to sell the home prior to renting it and an agreement with your tenant that allows you to show the property before the lease expires.

Although you have to report rent received as taxable income, you may be able to offset most or all of the income by deducting related expenses. Qualifying expenses include rental expenses — the broker fees, management fees, ads, property taxes, mortgage interest, upkeep and the utilities that you pay.

YOU CAN ALSO deduct depreciation. Homeowners who convert their houses to rentals are often disappointed by stingy depreciation write-offs. You write off your basis over 27.5 years, deducting 3.64 percent of the basis each year. Unfortunately, your home's basis may be less — perhaps far less — than its current value.

Your basis is essentially what you paid for the house (not including the land) plus the cost of improvements, minus any gain you rolled over from previous homes. If your basis is $100,000, a full year's depreciation would translate to a $3,640 deduction. Although that doesn't cost you anything out of pocket, it saves you more than $1,000 in taxes in the 28-percent bracket.

Even if it seems like more trouble than it's worth to figure depreciation on a temporary rental, you can't ignore it. The deduction may be small, but the law says your basis will be reduced by the amount of the allowable depreciation whether or not you claim it. That means you're going to have more taxable gain (or less tax-saving loss) when you finally sell the place.

WHEN TAX-DEDUCTIBLE expenses are taken into account, many instant landlords may find themselves in the red. There's no question that when expenses exceed the rental income, renting your home won't hike your tax bill. The big question is whether a loss can be deducted against other income — such as your salary or income from investments — to cut your tax bill.

There are two potential stumbling blocks between you and a loss deduction. First, the IRS says the temporary rental of a home can't produce a tax loss. If you're treating the home as your principal residence for rollover purposes, the agency says you can deduct rental expenses up to the amount of rental income, but no more.

But the IRS doesn't always have the last word, and on this issue a court has ruled that as long as a taxpayer was charging a fair rent, a rental loss is deductible. If you find yourself in this position, Brockman, for one, recommends that you claim the loss and take your chances on a possible IRS challenge.

But you could still lose the loss deduction to the passive loss rules. These anti-tax-shelter rules generally allow real estate losses to be deducted only against "passive" income — from other real estate investments, for example, or limited partnerships.

AN IMPORTANT exception is likely to allow you to deduct losses on the rental. A loophole in the passive loss rules lets you deduct up to $25,000 of rental losses if you are actively involved in the management of the property.

You can meet the active requirement, even if you hire a management firm to handle the property, as long as you approve tenants, set the rent and approve capital improvements. (The $25,000 allowance begins to be phased out when adjusted gross income exceeds $100,000 and disappears completely when AGI passes $150,000.)

When you sell your home for less than your basis, you don't have to worry about whether the rental is temporary because there will be no capital gain to roll over. But don't expect the federal government to let you write off the loss. The law does not allow the deduction of a loss on a principal residence.

Although converting to rental property is often promoted as a way around that restriction, there's a catch. The basis for figuring your loss begins as the lower of the adjusted basis or the fair market value of the house at the time of the conversion. In other words, any decline in value before you start renting the house would not count when figuring a tax loss.

Area firm will manage Chene Park property

The FOURMIDABLE Group of Farmington Hills is the management company for Chene Park Commons, a 144-unit apartment in downtown Detroit to be completed in the summer of 1992. Don Barden is the owner/developer.

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A design by Giffels Associates of Southfield has earned honors in R&D magazine's 1990 Lab of the Year competition. The 300,000-square-foot lab was built for Amoco Performance Product's research and development complex in Alparetta, Ga.

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Damone/Andrew of Troy has been named property manager for the 150 W. Jefferson Building, Detroit; I-75 Tech Park, Troy, and 805 E. Maple building, Birmingham.

William Adaline will serve as building manager for the 150 W. Jefferson Building, a 500,000-square-foot office tower.

I-75 Tech Park is a 78,000-square-foot light industry complex; the 805 E. Maple building is a 25,000-square-foot office/retail building.

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Quality Construction/Inrecon is sponsoring a contest to kick off its remodeling division with a grand prize of $7,000 in remodeling costs. Participants can pick up applications at Quality Construction, 7937 Schaefer in Dearborn, or at any Church's Lumber Yards in the area.

Contestants must fill out the application, enclose a color picture of the room they wish to have remodeled and explain in 150 words why they want the room remodeled. Deadline is Aug. 18. Winner will be announced Sept. 6.