THE WALL STREET JOURNAL®

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October 2005 Wall Street Journal - Real Estate

# Can Co-Owners Get a Break On Taxes When Uses Differ?

**Q:** My brother and I are thinking about purchasing a house in Martha's Vineyard. He would use it as a primary residence. I rent an apartment in New York. The house would be the only home I own, but I only would be there on weekends in the summer. We are considering setting up an LLC in our names. We both would take out a mortgage and would own the house 50/50. Would my mortgage be fully tax deductible as a primary residence?

*— Nate Morse, New York City*

**A:** I can tell you're a man on the hunt for deductions. You seem to already know that the IRS allows mortgage-interest and property-tax deductions on both a primary home and one second or vacation home. This means that although you rent your main home (which the IRS defines in Publication 523) in Manhattan, you can deduct mortgage interest and property taxes on your portion of the Martha's Vineyard residence as your second home if you itemize your deductions. Your property-sharing plan sounds on the surface like a win-win.

Now for the monkey wrench. Brad Hall, a certified public accountant and managing director of Hall & Co. CPAs in Irvine, CA., tells me you and your brother cannot hold the property in a limited liability company (LLC), since by definition, an LLC is a business. While you are correct that for tax purposes an LLC does allow mortgage-interest deductions on property, both partners would have to use that property as an investment (in your case, as a rental) and your brother couldn't make it a primary residence. In addition, Mr. Hall says that if you and your brother held the home in an LLC, it could complicate or eliminate his ability to claim the maximum $250,000 capital-gains tax exclusion allowed on the sale of a primary residence.

It probably would be best for you and your sibling to share the property under some other form of ownership. Mr. Hall proposes a tenancy-in-common, which will allow you to divide the property's ownership 50/50 on a mortgage that contains one or both your names. If you choose a tenancy-in-common, Mr. Hall advises you to hold your half as a vacation property and that your brother hold his half as a primary residence. If your brother's name is on the mortgage, you may get a better interest rate on a loan, since he is using it as his primary residence.

Regardless of whether you decide to take the tenancy-in-common route, Mr. Hall notes that your intended uses of the property could subject you to taxes on what the IRS calls "imputed rental income." The short definition: The IRS may view your use of the property as one in which a half-owner (your brother) is paying the other half-owner (you) nothing for his use of your half of the property. According to IRS logic, theoretically you are "gifting" him use of your property, and since he is not your dependent, you must report the fair rental market value as income and pay tax on it. This is a peculiar form of income tax, but it may apply in your case. If the IRS does view your half as a rental, you could take additional deductions on your income-tax filing, including expenses for home repairs, maintenance and depreciation, Hall says.

If your brother plans on using the whole property, you are better off treating your half as a rental and charging your brother rent. This way, you're eligible for a business loss deduction if the property loses value or capital gains tax treatment if it goes up when you sell. Either way, you are covered, says Mr. Hall.

Jake Engle, a certified financial planner in Seattle and principal of Financial Planning & Education LLC, says he agrees that a tenancy-in-common or a formal rental arrangement could benefit you. He urges you and your brother to devise a full "partnership agreement" about use of the jointly run property, complete with "exit strategies" and rules. Any "couple," whether a set of friends, siblings, or romantic partners who buy property together and are not married, need to think about the future.

"Both brothers need to consider all scenarios," he says. These scenarios include how you will divide tax payments, who will fund repairs and renovations and how the two of you will reconcile your property if one wants to sell and the other doesn't. "They need to visit their attorneys to adjust their wills, power of attorney agreements and other legal documents to cover all the what-ifs," he says.

***I would advise you to discuss these matters with your accountant or real estate attorney — and to invite your brother along.***