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Augusta Rule

The **Augusta Rule**, formally known as **IRC Section 280A(g)**, is a unique tax provision that allows homeowners to rent out their home for up to **14 days per year** without reporting the rental income to the IRS. Commonly used by business owners and self-employed individuals, this rule enables them to deduct business expenses paid to themselves for renting their home for legitimate business purposes. Here's how the Augusta Rule works and how to utilize it effectively:

1. Understanding the Basics of the Augusta Rule

The Augusta Rule originated from a tax exemption created for residents of Augusta, Georgia, who rented out their homes during the Masters Golf Tournament. Under this rule:

- **Rental Income Exemption:** Rental income earned from renting your home for **14 days or fewer** per year does **not need to be reported** as taxable income on your tax return.
- **No Deduction for Rental Expenses:** Since the income isn't taxable, you cannot deduct rental-related expenses like repairs, maintenance, or mortgage interest for those rental days.

- **Applies to Primary and Secondary Homes:** This exemption applies to primary residences as well as vacation homes, as long as they're not rented out for more than 14 days in a year.

For business owners, the Augusta Rule allows the homeowner to rent their personal residence to their business for business-related events and then deduct the rental expense as a business expense, while not having to report the income personally.

2. Requirements to Utilize the Augusta Rule

To qualify for the Augusta Rule:

- **Limit Rental Days to 14 or Fewer:** Ensure that the property is rented for **14 days or fewer** in a calendar year.
 - **Market Rent Documentation:** The rental rate must be **reasonable** and in line with what similar properties in your area would command.
 - **Document the Business Purpose:** Rentals for business use should be for a legitimate business purpose (e.g., board meetings, staff retreats, strategic planning sessions).
 - **Separate Business Entity:** The rule is easiest to apply if you have an LLC, S Corporation, or other separate legal entity that can pay rent to you personally for the use of your home.
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3. Steps to Implement the Augusta Rule

Step 1: Determine the Fair Market Rental Rate

- Research short-term rental rates for similar properties in your area (using platforms like Airbnb, VRBO, or local rental listings).
- Consider factors such as home size, amenities, location, and seasonality.
- Document the findings, and keep records of comparable properties and rates to support your rental rate if the IRS questions it.

Step 2: Schedule and Document the Business Events

- Identify legitimate business events that could be hosted at your home, such as:
 - **Quarterly Board Meetings**
 - **Staff Training Sessions**
 - **Annual Strategic Planning Meetings**
- Create a schedule and document each event, including meeting agendas, attendance lists, and any supporting notes or outcomes.

Step 3: Invoice the Business and Make Payment

- Generate an invoice from your business (e.g., LLC or S Corp) to yourself as a homeowner, listing the rental dates, hours, and fair market rental rate.
- Ensure that your business issues a check or transfers funds to you personally. This transaction should be recorded in your business's accounting system as a rental expense.

Step 4: Retain Records

- Keep detailed records of all meeting agendas, dates, and participant lists.
 - Save all invoices, payment records, comparable property documentation, and other related materials.
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4. Calculating the Deduction

To calculate the amount your business can deduct under the Augusta Rule:

- Multiply the **number of days** you rented out your home by the **daily fair market rental rate**.
 - Example: If your fair market rental rate is \$500/day and you rent your home to your business for 10 days, your business can deduct \$5,000 as a rental expense, and you do not need to report this amount as personal income.
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5. Example Scenario

Let's say you own a small business as an LLC, and you decide to hold quarterly board meetings at your home for planning and strategizing. Here's how the Augusta Rule could work for you:

- **Market Rate:** You determine that comparable rental properties in your area are renting for \$750/day.
- **Days Rented:** You use your home for 8 board meeting days throughout the year.
- **Business Deduction:** Your business can deduct **8 days x \$750 = \$6,000** as a rental expense.

- **Personal Exclusion:** You don't report this \$6,000 as income on your personal tax return.
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6. Important Considerations and Compliance Tips

- **Use Caution with IRS Scrutiny:** The IRS may scrutinize these deductions if they seem excessive or lack proper documentation, so it's essential to have clear records.
 - **Legitimate Business Purposes Only:** Renting your home for personal or informal events does not qualify.
 - **Fair Market Value Is Key:** The daily rental rate must be based on true fair market value and not arbitrarily set high, or the IRS may disallow the deduction.
 - **Consult a Tax Professional:** Since tax rules are complex and changing, work with a tax advisor to ensure that you're fully compliant.
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7. Common Uses and Benefits of the Augusta Rule

- **Reducing Taxable Business Income:** By paying rent to yourself, your business reduces its taxable income by the amount paid, effectively converting business income into non-taxable personal income.
- **Maximizing Deductions:** For small business owners who regularly hold meetings or training sessions, the Augusta Rule offers a way to maximize deductions while legitimately avoiding additional taxable income.

- **Estate and Succession Planning:** In family-owned businesses, the Augusta Rule can be used strategically to shift income within a family structure while minimizing overall tax liability.
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8. Potential Risks

- **Overestimating Rental Rates:** Charging an inflated rate may attract IRS scrutiny and potentially trigger an audit.
 - **Documentation Requirements:** Without thorough documentation, the IRS could deny the deduction.
 - **Risk of Audit:** Given the special nature of this rule, IRS agents may scrutinize Augusta Rule claims, so be prepared with full records.
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Conclusion

The Augusta Rule is a beneficial tax strategy for business owners, allowing them to receive tax-free rental income and reduce taxable business income, provided it is used correctly and within IRS guidelines. Proper documentation, setting a fair rental rate, and clearly defined business purposes are key to utilizing this rule successfully. Working with a knowledgeable tax professional can ensure that you're applying the rule correctly and getting the full benefit while avoiding pitfalls.

At Powell United we are credentialed Tax Professionals and would be happy to help you implement this strategy and many other often overlooked tax strategies..

Call today or visit our contacts page to set up your free consultation.

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www.powellunited.com

Sincerely,

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