

### **When can I deduct rental ex-**

**penses**—Generally, you deduct the rental expenses in the year you pay them. If your property is vacant, you may be able to deduct ordinary and necessary expenses while it is vacant. However, you cannot deduct any loss of rental income. Expenses incurred during a “pre-rental” period are not deductible until the property is rented.

**Is it a repair or an improvement**—A repair keeps the property in good condition but does not add *materially* to the value or prolongs the *economic life* of the property. This is an area that is constantly changing. The IRS continues to challenge taxpayers on the basis that the repair was actually an improvement.

**Other deductions**—Other deductions include:

1. Advertising
2. Cleaning and maintenance
3. Utilities
4. Insurance
5. Taxes
6. Mortgage interest and points
7. Commissions
8. Legal and accounting fees

9. Travel expenses, including a deduction for the standard mileage rate for business miles.
10. Tool rentals
11. Office supplies
12. Gardening and landscaping

**At-Risk Rules**—At-Risk rules place a limit on the amount you can deduct as losses from most rental properties. Generally, any loss from the activity is limited to the total of the cash plus the basis of your rental property.

**Passive Activity Rules**—Generally, all rental activities are considered passive activities. Deductions for losses on passive activities are limited. Generally, passive losses can only be offset against passive income. Passive losses can not offset other types of income.

**Deducting losses**—You may be able to deduct a rental property loss up to \$25,000, if you or your spouse actively participated in the management of the rental property. However, if your modified adjusted gross income is more than \$100,000, no deduction for the rental loss is allowed.



## **Common questions and answers about Rental Properties**



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Owning rental properties can provide many advantages to taxpayers, including tax deferrals of appreciated property, losses that may offset current income, earnings that do not affect social security benefits for distribution periods prior to full retirement age and retirement income. However, there are often many questions related to the taxation of rental properties.

**Depreciation**— Depreciation is an expense that is recognized over the taxable life of an *asset*. For example, your *basis* in your residential rental house is depreciated (expensed) over 27.5 years. Each *asset* has its own depreciable life and is depreciated separately. The Internal Revenue Service has issued guidelines to help taxpayers determine the taxable life of each asset.

They are:

- 3-year property,
- 5-year property,
- 7-year property,
- 10-year property,
- 15-year property,
- 20-year property,
- Nonresidential real property, &
- Residential rental property

**Basis**—Your basis is generally your costs in your *asset*. Your costs include the original purchase price plus improvements to the property.

**Asset**—Something you own—the house, refrigerator, stove, etc.

**Section 179**—Rental properties do not qualify for §179 deduction.

**Can I convert my personal residence to a rental property?** - Yes! Your *basis* in your residential rental property is the lesser of the Fair Market Value at the time of conversion, or your costs.

**What if I use the property as my personal residence for part of the year?**— You must allocate your expenses based on the personal use period and rental use period. This is done by computing the number of days for each use.

**Can I claim a home office deduction for my rental properties**—A taxpayer may take a home office deduction for rental properties. To deduct home office expenses, a taxpayer must use the space *exclusively* and *regularly*:

1. as a principal place of business,
2. as a place to meet or deal with clients and customers in the normal course of business, or
3. "in connection with" the business if the space is a separate structure from the residence (e.g., a barn or detached garage).