

Rental Real Estate Deductions

13th Edition

Stephen Fishman, J.D.

Table of Contents

Chapter 1 – Tax Deduction Basics for Landlords	1
Learning Objectives	1
Introduction.....	1
How Landlords Are Taxed.....	1
Income Taxes on Rental Income.....	1
Income Taxes on Profits When You Sell Your Property.....	1
Social Security and Medicare Payroll Taxes.....	2
Net Investment Income Tax	2
Property Taxes	3
What Is Rental Income?.....	3
Other Rental Income.....	3
IRS Reporting of Rental Income.....	4
How Income Tax Deductions Work	5
What Can You Deduct?	6
How Your Tax Status Affects Your Deductions.....	7
How Property Ownership Affects Taxes	7
Individual Ownership.....	7
Ownership Through a Business Entity.....	11
The Airbnb Landlord: Short-Term and Partial Rentals.....	13
Prorating Deductions for Short-Term or Partial Rentals	14
Landlords Who Provide Substantial Services	14
If You Rent Your Home for 14 Days or Less.....	15
If You Incur Rental Losses	15
Review Questions.....	17
Review Answers	18
Chapter 2 – Landlord Tax Classifications	21
Learning Objectives	21
Introduction.....	21
The Landlord Tax Categories.....	21
Business Owner Versus Investor	21
Are You a Business Owner or an Investor?	22
The Importance of Good Records	24
Tax Consequences	24
Are You Profit Motivated?	25
What Is a Not-for-Profit Activity?	26
Tax Consequences of Not-for-Profit Rentals	27
How to Show Your Profit Motive.....	27
Review Questions.....	31
Review Answers	32
Chapter 3 – Deducting Your Operating Expenses	33
Learning Objectives	33
Introduction.....	33
Requirements for Deducting Operating Expenses	33
Ordinary and Necessary	33
Current Expense.....	35
Business-Related.....	36
Reasonable in Amount.....	37
Operating Expenses That Are Not Deductible	37
Review Questions.....	38
Review Answers	39
Chapter 4 – Repairs.....	41
Learning Objectives	41

Table of Contents

Introduction.....	41
IRS Rules: Repair Versus Improvement.....	41
Three New Safe Harbors	42
Safe Harbor for Small Taxpayers (SHST).....	42
Routine Maintenance Safe Harbor	45
De Minimis Safe Harbor.....	47
Repair Versus Improvement Analysis Under the Regulations	48
Defining the Unit of Property (“UOP”).....	48
What is an Improvement?.....	50
Other Issues Under the Repair Regulations	54
How New IRS Regulations Affect Prior Years.....	55
How to Deduct Repairs and Maintenance	57
Making Tenants Pay for Repairs	57
Repairs Paid for or Performed by Tenants.....	58
Tips for Maximizing Your Repair Deductions	58
Patch, Mend, and Make Do—Don’t Replace	58
Properly Document Repairs	58
Do Preventive Maintenance	59
Delay Big Repair Expenses.....	59
Review Questions.....	60
Review Answers	61
Chapter 5 – Depreciation Basics	63
Learning Objectives	63
Introduction.....	63
Depreciation: The Landlord’s Best Tax Break.....	63
Understanding the Basics	64
What Property Can Be Depreciated?	64
How Depreciation Works.....	66
Taking Separate Deductions	67
How to Depreciate Buildings	68
What Is a Building?	68
When a Building Is Placed in Service	68
Determining a Building’s Basis	69
The Depreciation Period	73
How Much You Depreciate Each Year	74
Depreciating Additions and Improvements	74
Depreciating Land Improvements.....	77
Changes to Land	77
Structures Other Than Buildings	78
Depreciation Methods	78
Deducting Personal Property	78
What Is Personal Property?	78
How to Deduct or Depreciate Personal Property	79
De Minimis Safe Harbor	80
Materials and Supplies Deduction	83
Bonus Depreciation	84
Regular Depreciation	86
When Is Personal Property Placed in Service?	86
Determining the Basis of Personal Property	86
Depreciation Period	87
First-Year Depreciation	88
Depreciation Methods	88
Listed Property	90
Section 179 Expensing	91
Short-Term Rentals.....	92
When You Sell Your Property	93

Table of Contents

Adjusted Basis.....	93
Effect of Adjusted Basis When You Sell	94
Like-Kind Exchanges: Deferring Taxes on Rental Property.....	95
The Home Sale Exclusion—Avoiding Taxes When You Sell Your Rental	96
Tax Reporting and Record Keeping for Depreciation	98
Review Questions.....	100
Review Answers	103
Chapter 6 – Maximizing Your Depreciation Deductions	107
Learning Objectives	107
Introduction.....	107
Determining the Value of Your Land and Buildings.....	107
There Is No One Way to Determine Land and Building Values	108
Figuring Your Improvement Ratio.....	108
Property Tax Bill	109
Replacement Cost	110
Buyer-Seller Valuation	111
Comparable Land Sales.....	112
Segmented Depreciation.....	112
Identifying Your Personal Property	114
Determining Fair Market Value of Personal Property	115
Steps to Calculate Segmented Depreciation	115
Review Questions.....	118
Review Answers	120
Chapter 7 – Interest.....	123
Learning Objectives	123
Introduction.....	123
Interest Landlords Can (and Can't) Deduct.....	123
Mortgage Interest.....	124
Interest, Not Principal, Is Deductible.....	124
Expenses to Obtain a Mortgage	124
Private Mortgage Insurance	125
Mortgage Refinancing.....	125
Mixed-Use Properties	125
Other Interest Expenses	125
Credit Cards and Loans	125
Car Loans.....	126
Home Offices.....	126
Home Equity Loans	126
Points and Prepaid Interest.....	126
Interest on Construction Loans.....	127
Loans With Low or No Interest	127
Loans on Rental Property Used for Nonrental Purposes.....	128
Keeping Track of Borrowed Money	128
30-Day Rule	129
Allocation Rules.....	129
Review Questions.....	130
Review Answers	132
Chapter 8 – Start-Up Expenses.....	135
Learning Objectives	135
Introduction.....	135
What Are Start-Up Expenses?	135
Determining Your Business Start Date	136
Rental Business Begins When You Offer Property for Rent.....	136
Expanding an Existing Rental Business	137

Table of Contents

Avoiding the Start-Up Rule's Bite	138
How to Deduct Start-Up Expenses	138
Expenses You Can Deduct	139
Costs That Are Not Start-Up Expenses	139
If Your Business Doesn't Last 15 Years	141
If Your Business Never Begins.....	141
Review Questions.....	142
Review Answers	143
Chapter 9 – The Home Office Deduction.....	145
Learning Objectives	145
Introduction.....	145
Qualifying for the Home Office Deduction.....	145
Threshold Requirements.....	146
Additional Requirements.....	146
Calculating the Home Office Deduction.....	147
How Much of Your Home Is Used for Your Rental Business?	148
What Expenses Can You Deduct?	148
Simplified Home Office Deduction Method	150
IRS Reporting Requirements	150
Deducting an Outside Office	151
Renting an Office.....	151
Using an Office in Your Rental Building.....	151
Buying a Separate Office Building.....	151
Review Questions.....	152
Review Answers	154
Chapter 10 – Car and Local Transportation Expenses	157
Learning Objectives	157
Introduction.....	157
Deductible Local Transportation Expenses.....	157
Travel Must Be for Rental Activities.....	158
Driving From and to Home	158
The Standard Mileage Rate	159
How the Standard Mileage Rate Works.....	159
Requirements to Use the Standard Mileage Rate	160
The Actual Expense Method	161
How the Actual Expense Method Works.....	161
Record-Keeping Requirements	162
Vehicle Depreciation Deductions.....	162
Leasing a Car	164
Other Local Transportation Expenses	165
Reporting Transportation Expenses on Your Tax Return.....	165
Review Questions.....	166
Review Answers	167
Chapter 11 – Travel Expenses	169
Learning Objectives	169
Introduction.....	169
What Are Travel Expenses?.....	169
Where Is Your Tax Home?.....	170
Your Trip Must Be for Rental Business.....	170
Deductible Travel Expenses.....	172
Traveling First Class or Steerage	172
Taking People With You.....	172
How Much You Can Deduct.....	173
Calculating Time Spent on Rental Activities	173
50% Limit on Meal Expenses	174

Table of Contents

Review Questions.....	175
Review Answers	176
Chapter 12 – Hiring Help	177
Learning Objectives	177
Introduction.....	177
Deducting Payments to Workers.....	177
Operating Expenses	177
Start-Up Expenses.....	178
Depreciation Expenses	178
Employees Versus Independent Contractors.....	178
Tests to Determine Workers’ Tax Status	179
Common Classifications for Workers.....	180
Tax Rules When Hiring Independent Contractors.....	180
Threshold for IC Income Reporting.....	181
Obtaining Taxpayer Identification Numbers.....	182
Filing IRS Form 1099-MISC	183
Reporting Requirements Don’t Apply to Corporations.....	184
New Hire Reporting Requirements for ICs.....	184
Paying Independent Contractors’ Expenses	184
Tax Rules for Employees	185
Employer’s FICA Contributions	185
FUTA.....	185
FITW	186
State Payroll Taxes.....	186
Hiring Your Family	187
Employing Your Children	187
Employing Your Spouse.....	188
Rules to Follow When Employing Your Family	188
Hiring a Resident Manager	191
No Payroll Taxes for Free Lodging.....	191
Minimum Wage Requirements	192
Review Questions.....	193
Review Answers	195
Chapter 13 – Casualty and Theft Losses.....	197
Learning Objectives	197
Introduction.....	197
What Is a Casualty?.....	197
External Force Required	198
Theft or Vandalism.....	198
Calculating a Casualty Loss Deduction	198
Insurance.....	199
Property a Total Loss.....	199
Property a Partial Loss.....	199
Deducting Separate Components	200
Damage to Your Home Office	201
Effect of Casualty Losses on Basis	201
Disaster Area Losses	201
Repair and Replacement Costs for Casualty Losses	202
Casualty Gains	202
Tax Reporting and Record Keeping for Casualty Losses	203
Review Questions.....	204
Review Answers	205
Chapter 14 – Additional Deductions.....	207
Learning Objectives	207
Introduction.....	207
Dues and Subscriptions	207

Table of Contents

Education Expenses	207
Before You Are in Business	208
Traveling for Education	208
Gifts.....	208
Insurance for Your Rental Activity	209
Homeowners' Insurance for Your Home Office.....	209
Insurance for Short-Term Rentals	209
Car Insurance	209
Prepaying Your Insurance Premiums	210
Legal and Professional Services	210
Buying Long-Term Property	210
Management Fees	210
Starting a Business	210
Accounting Fees.....	211
Meals and Entertainment	211
Whom Can You Entertain?	211
You Must Discuss Your Rental Activity.....	211
Calculating Your Deduction.....	212
Taxes	212
Real Property Taxes	212
Employment Taxes	213
Tax Break for Accessibility Changes	213
Energy Efficiency Deduction	213
Unpaid Rent	214
Review Questions.....	215
Review Answers	216
Chapter 15 – Tax Deductions for Part-Time or Partial Rentals.....	217
Learning Objectives	217
Introduction.....	217
Calculating Personal and Rental Use	217
Calculating Personal Use.....	217
What Is a Fair Rental Price?	217
Calculating Rental Use	218
Putting Your Calculations Together.....	218
Calculating Your Tax Deductions	219
Direct Expenses Are Fully Deductible	219
Expenses That Must Be Prorated.....	219
Renting Your Entire Home	220
Renting Out a Room Part Time	220
Renting Out a Room Full Time.....	221
Review Questions.....	223
Review Answers	224
Chapter 16 – Deducting Rental Losses	225
Learning Objectives	225
Introduction.....	225
What Are Rental Losses?	225
Overview of the Passive Loss Rules	226
What Are the PAL Rules For?	226
How the PAL Rules Work.....	226
The \$25,000 Offset.....	228
Requirements	228
Determining Your Offset Deduction.....	231
The Real Estate Professional Exemption	231
Real Estate Professional Test	232
Materially Participate in Rental Activity	237

Table of Contents

Applying the Test	238
What Happens If You Qualify for the Exemption?	239
The Real Estate Professional Exemption Is Not Optional	240
Record Keeping for the Real Estate Professional Exemption	240
Deducting Losses for Airbnb and Other Short-Term Rentals.....	242
Rentals Subject to Vacation Home Rules	242
Hotel Business.....	244
Deducting Suspended Passive Losses.....	245
You Must Have Passive Income.....	246
The \$25,000 Offset.....	246
The Real Estate Professional Exemption	246
Profits From Sale of Property	246
Tax Reporting for Passive Rental Losses	247
Strategies for Dealing With the Passive Loss Rules	247
Lower Your Rental Expenses.....	247
Use Home Equity Loans	248
Generate More Passive Income.....	248
At-Risk Rules.....	249
How to Deduct Rental Losses	250
Calculating Your Net Operating Loss	250
Carrying a Loss Back.....	251
Electing to Carry Forward an NOL Instead	251
Review Questions.....	253
Review Answers	255
Chapter 17 – Record Keeping and Accounting.....	257
Learning Objectives	257
Introduction.....	257
What Records Do You Need?	257
Paper Versus Electronic Records.....	257
Create Your Own Spreadsheet	258
Software Programs	258
A Simple Record-Keeping System	259
An Easy Filing System	259
Separate Checkbook and Credit Cards	259
Dealing With Receipts, Canceled Checks, and Other Supporting Documents.....	260
Expense Journal.....	263
Rental Income Journal	266
Asset Records	267
Records Required for Local Travel	269
Records Required for Long-Distance Travel, Meals, Entertainment, and Gifts	271
How Long to Keep Records	272
When You Don't Have Proper Tax Records	273
Accounting Methods	274
Cash Method	274
Accrual Method.....	276
Tax Years.....	277
Review Questions.....	278
Review Answers	279
Chapter 18 – All About Schedule E.....	281
Introduction.....	281
Who Must File Schedule E?	281
Filling Out Schedule E	282
Filing IRS Forms 1099 (Lines A and B)	282
Property Description (Line 1).....	285
Dual Use Properties (Line 2).....	285

Table of Contents

Qualified Joint Venture (Line 2).....	285
Rental Income (Line 3).....	285
Royalties Received (Line 4)	286
Expenses (Lines 5-20)	286
Rental Summary (Lines 21-26).....	287
Review Questions.....	289
Review Answers	290
Chapter 19 – The Net Investment Income Tax.....	291
Learning Objectives	291
Introduction.....	291
How the NII Tax Works	291
What Is the NII Tax?	291
Who Is Subject to the NII Tax?.....	291
Amount of the Tax	292
Real Estate Professional Exemption From the NII Tax	293
Real Estate Professional.....	293
Material Participation in Rental Activity.....	293
Rental Activity a Business	294
Planning to Avoid the NII Tax.....	294
Review Questions.....	296
Review Answers	297
Glossary.....	299
Index	303