

Fact Sheet on Rental Income and Expenses

As the owner of rental real property, it is important that you are aware of everything that counts as income so that you do not face underpayment tax penalties. It is also important that you are aware of all deductible expenses so that you do not overpay your taxes. This letter highlights some of the tax rules applicable to you as a landlord.

- Any expenses **paid by a tenant** on your behalf will be considered as income to you. However, the corresponding expenses may also be deductible as rental expenses.
- Any property or service you receive in lieu of money will be considered as income. This income is based on the fair market value of the property or services received.
- Lease payments with an option to buy are usually counted as rental income. If the tenant buys the property, payments received after the date of sale are generally counted as part of the selling price.
- Security deposits are not counted as income if they are to be refunded at the end of a lease period **and** the funds are held in *reserve* (not spent). However, any funds withheld from a deposit are counted as income in the year they are retained.
- While the cost of repairs/maintenance is currently deductible, including the cost of labor and materials, landlords cannot deduct the value of their own labor.
- Improvements that add to the value of rental property or prolong its useful life may **not** be deducted as current expenses. These improvements must be added to the value of the property and depreciated over time (generally 27.5 years). Equipment, furniture, fixtures, etc. must be depreciated but over a shorter period of time.
- If you own rental property that you also **use for personal use**, you may be able to deduct the expenses on a proportional basis. You may use any reasonable method for calculating what portion of the property should be considered rental, for example, the square footage method.
- If you sell rental property the taxation is very complicated. Please let us know immediately if you sell your rental property. You may have to prepay the tax liability.

If you rent property that you also use as a residence, such as a **vacation home**, special rules apply. If the property is rented for fewer than 15 days during the tax year, you are not required to include the rent you receive as income. However, you are also not permitted to deduct expenses associated with the rental.

If you rent such a property for more than 14 days during the tax year, deductible expenses must be calculated based on the number of days the property is used for each purpose.

If you have any questions regarding the deductions to which you are entitled to as a landlord, or if you are interested in discussing other ways in which to minimize your taxes, please feel free to contact our office at your earliest convenience. Plus, request our special worksheet for reporting rental activity.

Sincerely yours,

Berman and Sons, LTD