

RENTAL REAL ESTATE

Many taxpayers invest in owning rental property for the tax benefits. Yes, rental property can result in a good investment; however, it is important to note that detailed records of your activities are required. Treat your rental property as the separate business it is by keeping a separate bank account and credit card.

Following the guidelines listed here will assist you in complying with the rules and regulations overseeing rental properties while taking advantage of possible tax benefits.

Does It Qualify as Rental Property

Your residential or commercial property is considered rental property if it is rented at fair market value and you have a signed rental agreement.

If your rental property is rented to a family member at less than fair market value, it is not qualified rental property.

Your vacation property is considered rental property if it is used personally less than 14 days or 10 percent of the total days used.

Tax Benefits

Some tax benefits of rental real estate can be leveraging your cash to acquire a higher priced property and the appreciation of that property over time; the ability to “cash out” of a property’s equity upon refinancing and not pay tax on the transaction; and the ability to “trade-up” to a higher valued property in a tax-free exchange of like-kind property.

These advantages are available to all taxpayers, not just wealthier taxpayers.

Deductible Expenses

Some of the expenses tax laws allow you to deduct from rental income are mortgage interest, property taxes, insurance, advertising, landscaping, interest on loans for improvements, and maintenance. You can also deduct depreciation on structures and improvements, but land cannot be depreciated.

Travel can be a deduction if the primary purpose is to collect rental income or to manage or maintain your rental property.

Rental Losses

If you’re not a real estate professional, here’s how your rental loss could affect your income tax. If you actively participate in activity associated with the property and your adjusted gross income does not exceed \$100,000, you can deduct up to \$25,000 in losses. The \$25,000 allowable loss phases out between \$100,000 and \$150,000 of adjusted gross income.

If you do not meet the deduction requirements, your net losses are suspended; i.e., held over until a year in which you meet the requirements for deduction, or until you sell the property.

Improvement or Repair

Property improvements and repairs are reported differently on your tax return. So it is important to understand the definition of these terms and how they are treated for tax purposes.

Improvements add to the value of the property and prolong the useful life and are depreciated. A repair maintains the property in good condition and is deductible in the year paid.

Sale of Property

When rental property is sold for a profit, a taxable transaction occurs, but the taxation is typically at the lower capital gains rates (just like the gain on the sale of a share of stock) with one exception: the **depreciation** taken on the rental property is taxed at normal tax rates.

If the property is sold at a loss, the loss is considered “ordinary” and not subject to the capital loss limitations (no more than \$3,000 per year).

Tax Deferred Exchanges

Another advantage of owning rental property is the ability to exchange the property you own for a “like-kind” property in what is known as a Section 1031 “tax-deferred exchange”. This typically defers the tax on any profit until you sell the new property.

Though exchanges can be a very profitable way to acquire new property, they require careful planning and professional assistance, and are highly regulated. We can assist you in securing expert counsel to facilitate the transaction.

Managing Rental Property

Before you invest, do some research to find out the work it takes to manage rental property. It can be worth the effort, but understand what to expect before beginning. You can be successful by finding the right property in the right location at the right price, choosing the right tenants, and maximizing your tax breaks.

This information is general in nature and should not be used as the final authority. Contact us for further details and professional guidance in identifying and utilizing all the rental real estate deductions and advantages for which you qualify.