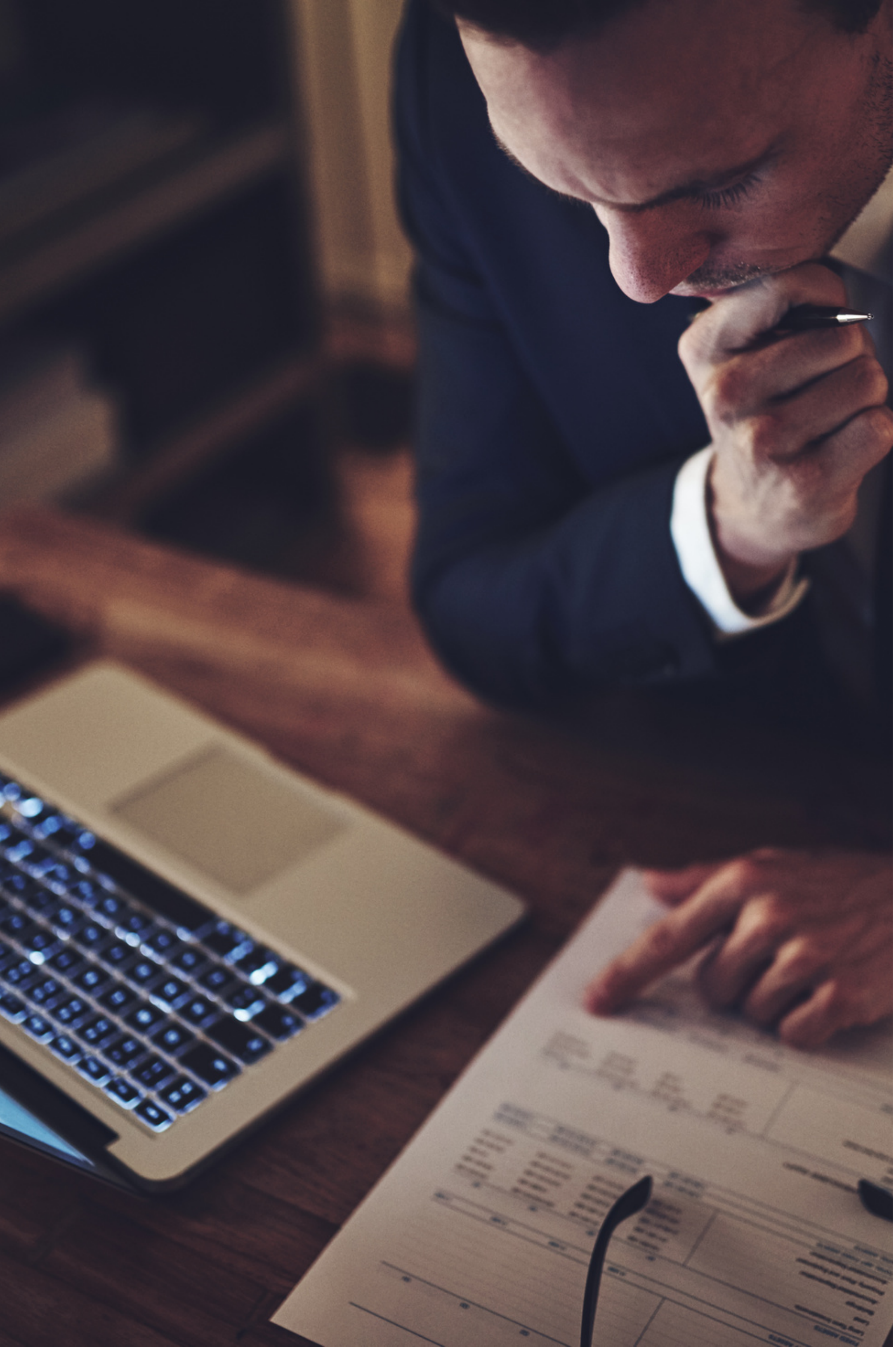
RentersWarehouse®

Tax Guide for Landlords

GUIDE:

Everything You Need to Know About Taxes



Introduction

Tax time can be stressful for most people. But for landlords, there are reasons to feel optimistic.

There are a number of opportunities for landlords to save, thanks in large part to the wide range of deductions that are available for them. This includes everything from the well-known deductions like travel expenses or maintenance costs to bigger, yet often-overlooked deductions such as depreciation or mortgage interest.

But deductions aren't the only way to save at tax time. There's a lot that landlords can do throughout the year to structure their finances in a way that'll help them to save as well. For landlords, it's important to ensure that you're familiar with all of the available deductions so that you can lower your tax bill. There are also a number of tax strategies that you can employ as well, either throughout the year or when selling a rental, that can help to reduce the amount of tax that you'll owe.

Taxes might not be the most glamorous aspect of being a landlord, but there's a lot that you can do ahead of time to make the process much easier when April comes around.

With this in mind, let's take a look at what landlords should know about taxes this year.

See also: Filing Your Taxes When You're a Landlord

What Counts as Rental Income

First of all, let's take a look at what's considered taxable rental income.

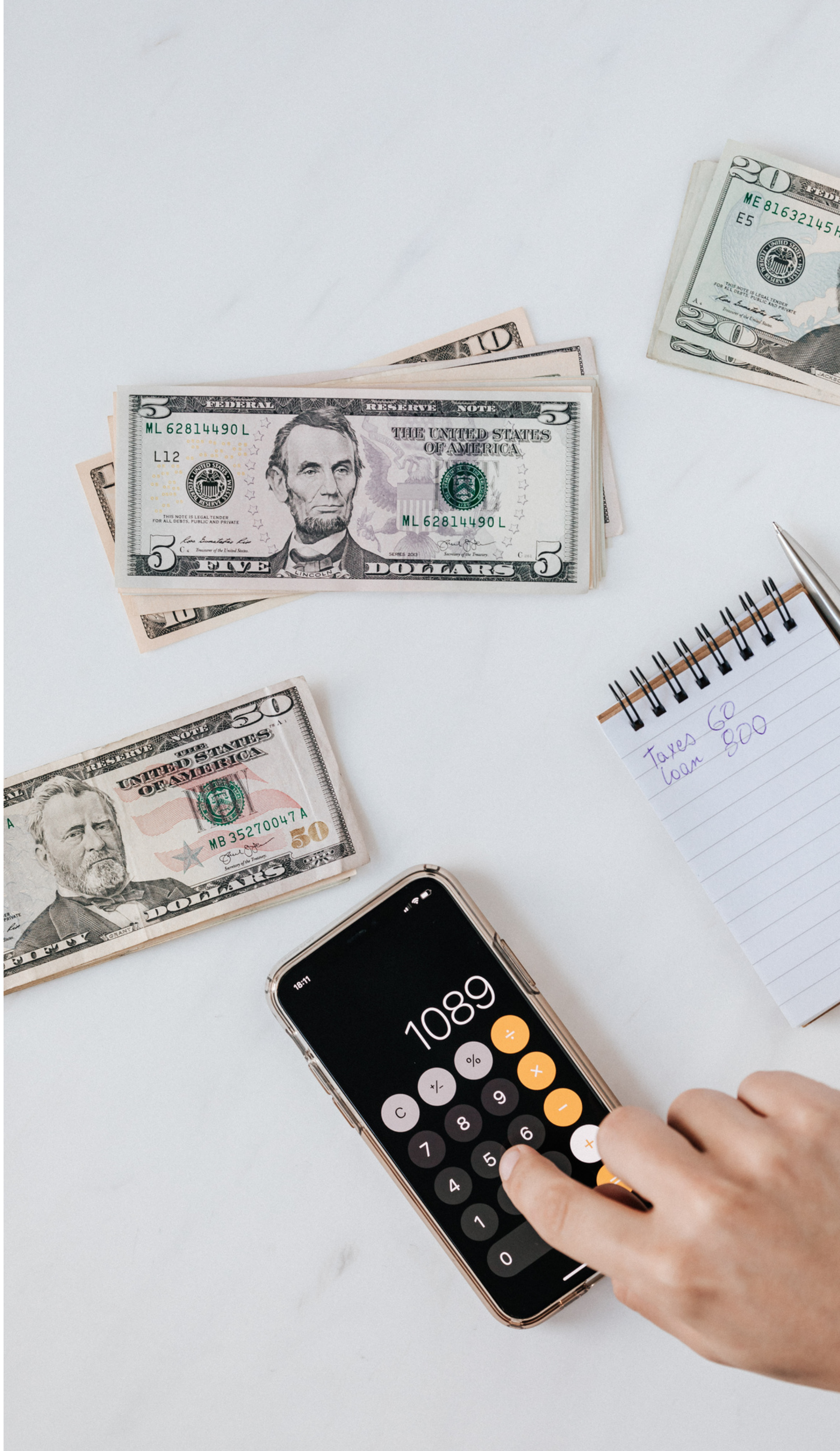
Anything that you generate through your rental properties is considered rental income and taxable.

According to the IRS, rental income is, "Any payment you receive for the use or occupation of property."

This includes your standard rent payments as well as other income that you receive as well. Here are some things that are considered taxable rental income:

- Rent payments
- Rent that's paid in advance
- Security deposits that are kept (not returned to the renters)
- Lease cancellation fees
- Any services that you receive from the tenants in place of rent

As a general rule, if you received money from your rental property, there is a very good chance that it's considered rental income. It's important that you claim all income that you receive in connection with your rental.



What Counts as Rental Income

Rental property can open up the door for some great tax deductions. Deductions can lower the amount of tax that you owe. Still, millions of landlords pay more tax than they need to each year. This is because they aren't aware of the myriad of deductions that are available for landlords.

Understanding the deductions that are available to landlords can help you to save when filing your taxes. This is especially true if you have a mortgage out on the property, as mortgage interest is tax-deductible, and often comprises a significant deduction.

Here's a look at some of the deductions that are available to landlords:

- **Advertising**

Advertising costs for your rental are deductible. This includes online listings, newspaper ads, and signs.

- **Tenant Screening**

Tenant screening expenses can also be claimed. This includes credit reports, criminal background checks, identity verifications, and more.

- **Repairs and Maintenance**

Maintenance and repairs are a big part of owning rental properties. There are plenty of repairs that arise and maintenance that needs to be done to keep things working. It is important to distinguish, though, between basic maintenance and repairs, and things that can be considered improvements.

While maintenance and repairs are fully deductible in the year that they're incurred, improvements are not. Maintenance and repairs are things that are needed to keep the property in rentable condition and do not add value. As long as the repairs were done to maintain the property and do not add value to it, they can be deducted fully in the year that they were performed.

Improvements can still be deducted, but they will need to be depreciated over a set number of years. See IRS publication 527, table 2.1 to learn more about depreciation schedules.

- **Utilities**

Any utilities that you pay for at your rental are deductible. This includes electric, gas, water, sewage, and garbage. You can also deduct utilities such as internet or cable. If your tenant reimburses you for the utilities, they are still considered deductible; just make sure you claim the reimbursement as income.

- **Travel**

Many landlords have properties out of town that require them to travel a fair distance to manage or inspect. The cost involved with travel can add up, but come tax time, that could work in your favor. Travel costs to and from your rental are deductible. For long-distance landlords, this could include airfare, hotels, and 50% of meal costs. For landlords who might be driving to perform repairs or maintenance on the property, the cost of local travel is deductible as well. You can keep track of your fuel and vehicle expenses, or use the IRS' standard mileage rate for your deductions. For 2021, this was 56 cents per mile. For 2022, the standard mileage rate is 58.5 cents per mile.

- **Legal and Professional Fees**

As a landlord, you may incur professional and legal fees. But the good news is that all of these fees are deductible. This includes legal expenses, property management fees, and accounting costs.

- **Homeowners Association (HOA) Dues**

Homeowners Association (HOA) dues are deductible as well.

- **Commissions**

Commissions and incentives can also be deducted. This includes incentives for outgoing tenants. For example, say if you offer to pay an outgoing tenant if they find a new tenant for you. That incentive can be deducted.

- **Equipment, Supplies, and Expenses**

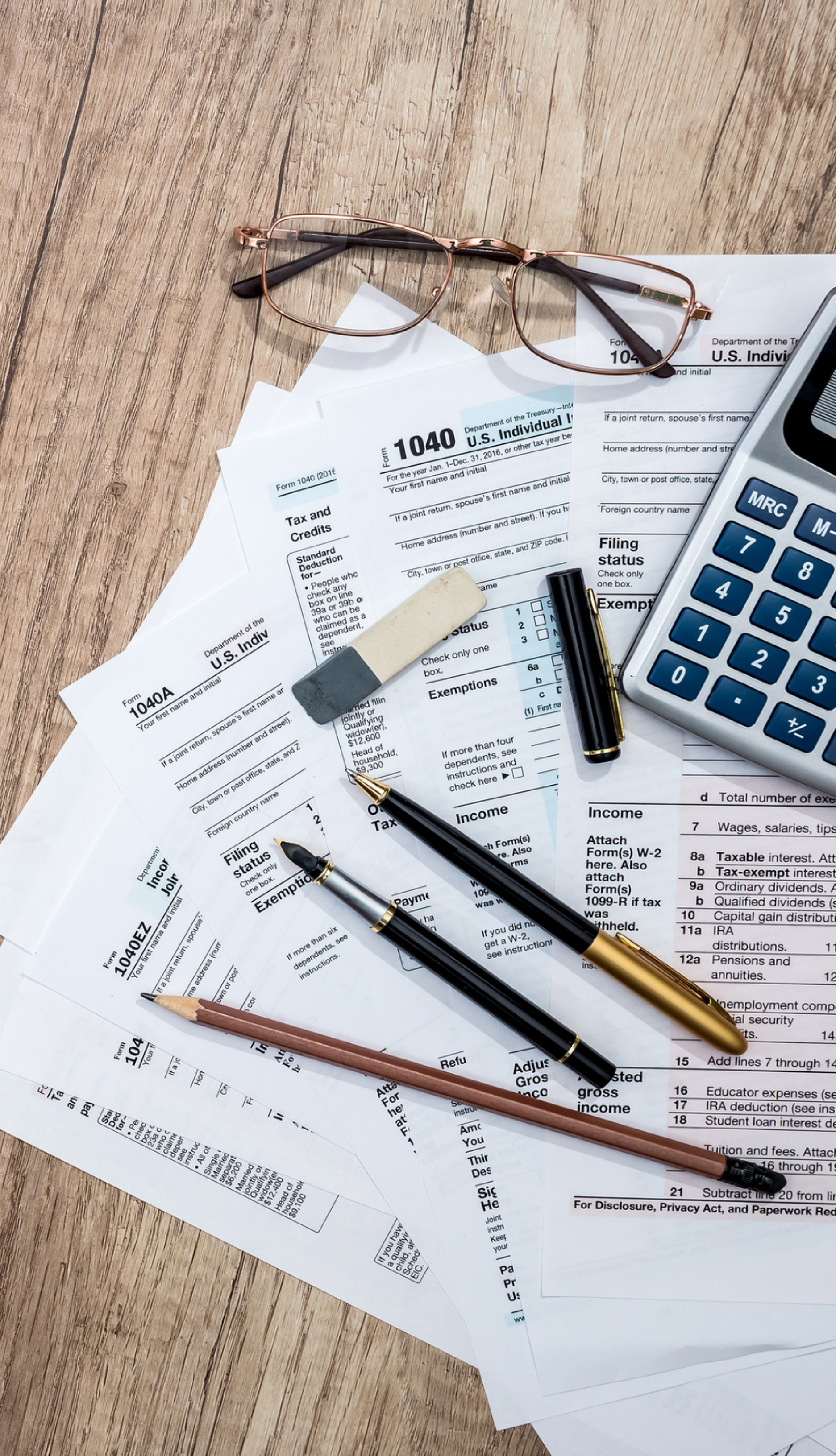
New supplies and equipment, including a phone and laptop, can also be deducted. As long as they're used specifically for your rental business. Even things like printer toner, paper, and stamps can be deducted as long as you're able to demonstrate that they are for business purposes.

- **Home Office Deduction**

If you use a portion of your home for rental-related business, then you can deduct this as well. You can use the IRS' method for calculating this deduction and deduct $5 per square foot up to 300 square feet.

- **Mortgage Interest**

If you have a mortgage on your property, then be sure to include mortgage interest on your taxes. Your bank or lender should send you a 1098 form, showing you how much mortgage interest you paid in the year.



- **Points**

Likewise, if you've purchased any points when taking out a mortgage to keep your interest rate low –those are deductible as well. You can find these on your 1098 forms as well.

- **Insurance**

There are plenty of insurance policies that are required when you own a rental property. Fire and flood insurance, liability, and more; all of their premiums are deductible. If you have employees, you can also deduct workers' compensation and health insurance for them.

- **Mortgage Insurance (PMI/MIP)**

Speaking of insurance, if you have a mortgage on your property and have mortgage insurance, you can deduct this as well. You should be able to find out how much your mortgage insurance is on the 1098 forms that you've received from the bank.

- **Employees**

If you hire employees or enlist independent contractors to help you with your rental business, you can use their wages as a deduction as well. Their Social Security contributions and any benefits that you offer are tax-deductible as well.

- **Taxes**

Yes, taxes are deductible as well. Some landlords don't know this, but you can usually deduct taxes as well. This includes property tax, as well as city tax, and even taxes for employees that you hire for your rental properties. This deduction caps out at $10,000.

- **Depreciation of the Property**

Depreciation is another significant deduction that landlords can take and often comprises one of the biggest deductions. More on depreciation below.

Want to learn more about landlord deductions? See: Top-Ten Deductions for Landlords and see other deductions that you may be eligible for.

Note: Business Vs. Personal Use

So how can you tell if something's personal or business-related? What if you purchase something that you're planning to use for both? If this is the case, then you'll want to determine how much of the time you use the item for personal use and how much you use it for rental-related activities. So let's say you use your new computer for business purposes 60% of the time. In that case, you can only deduct 60% of the item.

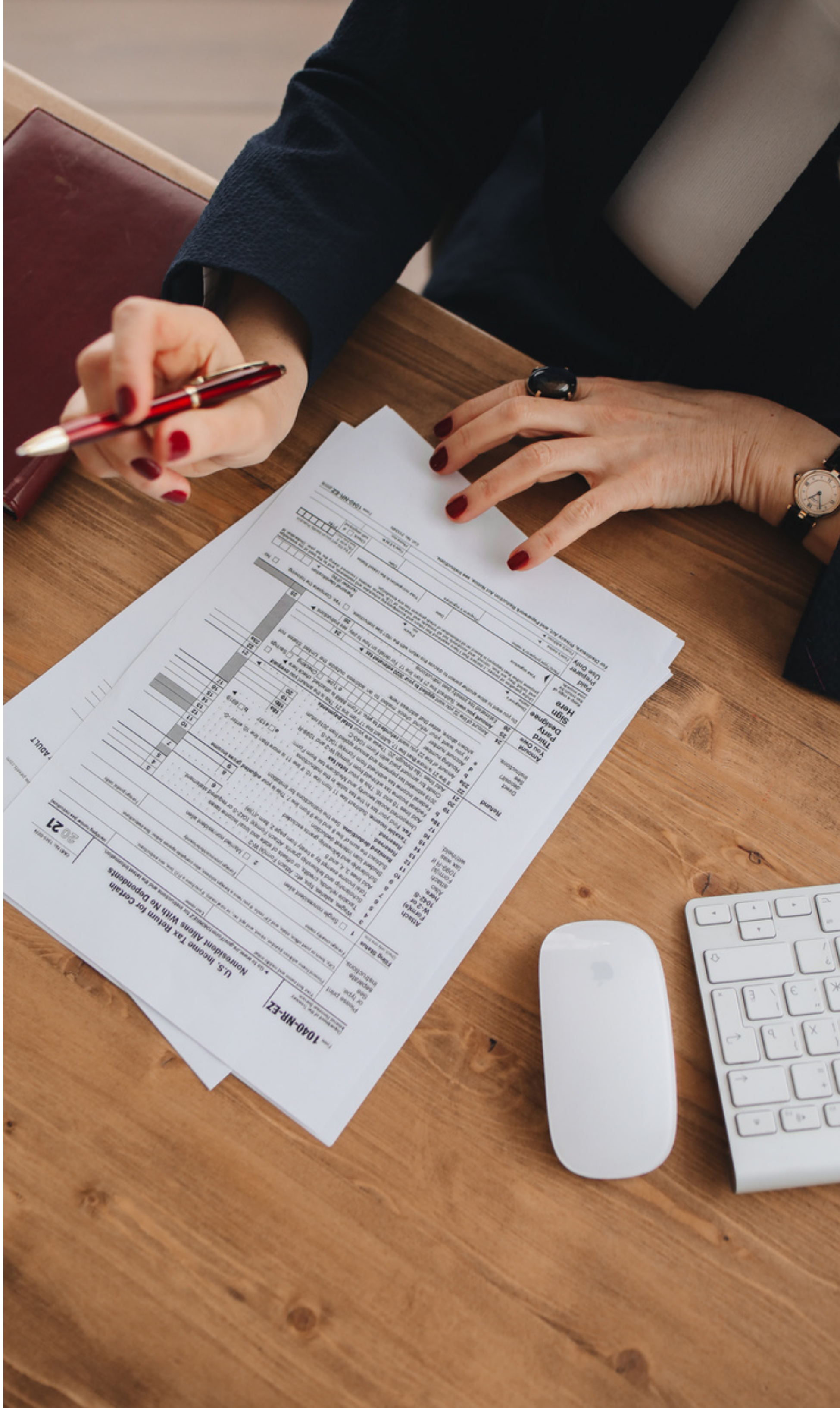
Rules for Certain Deductible Expenses

The IRS has very specific rules on certain deductible expenses that outline what is able to be deducted and how much you can deduct. In some cases, record-keeping requirements are mentioned as well.

Here's a look at some of the expenses that have special rules and requirements:

- Home Office Expenses – There are strict requirements for taking the home office deduction. Learn more here.
- Travel – Travel expenses to and from the rental can usually be deducted. This will depend on the purpose of your business and how much time you spend on business while away. If you're traveling for improvements rather than repairs or maintenance, then you'll need to depreciate the travel costs; you cannot claim them all in one year. You can usually deduct 50% of meal costs when you're traveling for rental-related business. See this page to learn more.
- Vehicle Expenses – The standard mileage rate for this expense changes from year to year.
- Business Gifts – Business gifts are limited to $25 per person.
- Bad Debts – Some bad (or unpaid) debts are deductible. Unpaid rent is generally not considered deductible, however.
- Casualty Losses – You can deduct some losses due to a casualty like theft or fire, but you may not be able to deduct the entire cost of the property destroyed. That will depend on whether the loss was covered by insurance and whether the property was stolen or completely destroyed. Usually, small landlords can deduct up to $25,000 in rental property losses every year.

For more information on these deductions and the rules for them, see IRS Publication 463: Travel, Entertainment, Gift, and Car Expenses.



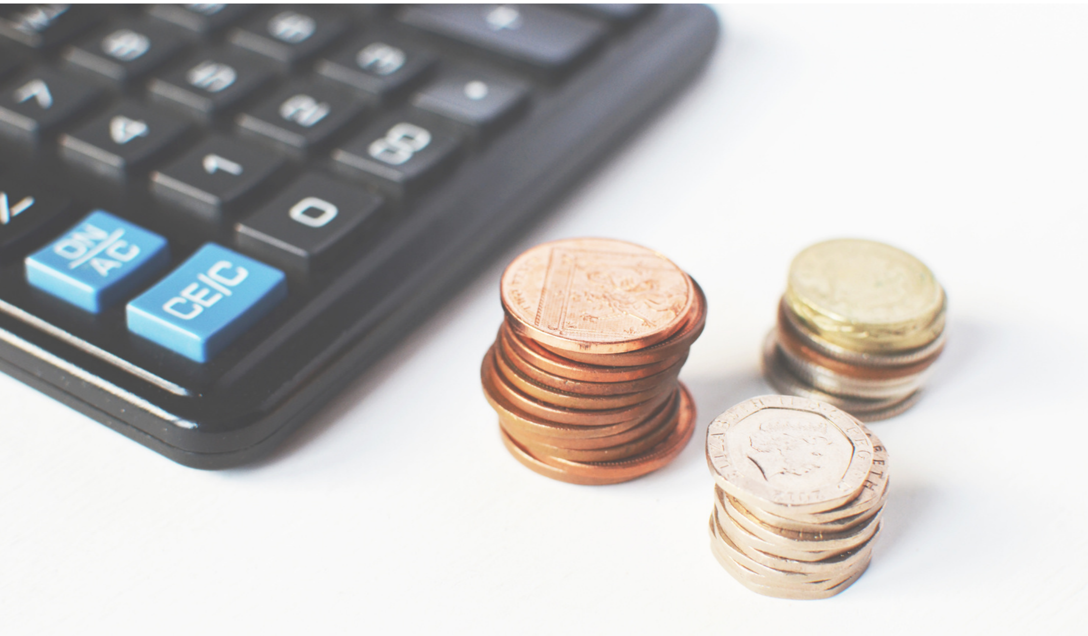
What's Depreciation and How Does It Work?

Depreciation is one of the biggest tax deductions available to real estate investors, but it's one deduction that can seem complicated at first, so we're here to break it down and make it easier to understand.

First of all, what is depreciation? According to the IRS, your rental property is a depreciating asset, something that's losing value each year. Whether or not this is the case is beside the point, when it comes to paying taxes, the IRS allows you to treat your rental property like it's losing value. What this means is that you can claim a certain amount each year as depreciation. For the rental property itself, you cannot claim this "loss" over one year; instead, you have to spread it out and claim it back over multiple years, 27.5 years to be exact.

While depreciation can take a significant portion off of your tax bill, it's something that you'll have to pay back should you ever sell the property. That's because depreciation allows you to defer tax, you'll basically be pushing the amount of tax that you owe forward until the home is sold and at which time it must be recaptured. Although there are ways around this as well.

What if you opt out of this deduction? The IRS doesn't allow you to do this. They require landlords to take depreciation. If you don't, then you could still be held liable for paying depreciation recapture tax when you sell the property.



Changes to the Tax Code

When the Tax Cuts and Jobs Act passed in 2017, landlords were one of the winners. At least in some ways. Here's a look at a few changes that this legislation brought and how it's impacting landlords today.

- 20% Pass-Through Deduction

If your rental activity qualifies as a business for tax purposes, then you might be able to deduct up to 20% of your income. In order to qualify for the pass-through deduction, your rental activity must qualify as a business.

This means that you must:

- Earn a regular profit from your rental properties
- Keep books for your rentals that are separate from your personal ones
- Keep records documenting services
- Perform 250 hours of services each year on your rental properties

This deduction began in 2018 and is scheduled to last through 2025.

- Bonus Depreciation Through 2022

Thanks to the TCJA, some assets can be fully deducted in the year that they are purchased (through 2023, after which it will start to be phased out). While this cannot be used to depreciate real property, it can be used for a number of assets or improvements that are often used in real estate investing. [Learn more about bonus depreciation](#).

- Keep Good Records

Keeping good records has always been important, but it's even more so in recent years. [Since 2019](#), the IRS requires landlords to maintain time reports, logs, or records showing the following:

- Hours of all services performed
- Description of the services performed
- Dates on when they were performed
- Names of the people who performed them

While you don't need to file the records with your return, you should keep them available in case the IRS requests them.

Tips to Make Tax Time Easier

Tax time can be stressful for anyone. As a landlord, the pressure and stress can be amplified. Don't get caught up in the stress of tax season. Here are a few tips to help make the time and process easier.

- **Don't Wait Until the Last Minute**

If you are in the same category as 20-25% of other Americans, then you will be waiting until the last two weeks in April to scramble and get your taxes done. But waiting until the last minute can lead to errors and missed deductions. Instead, get started working on your taxes early and ensure you have all the needed documents. If you don't have the time to carefully process your taxes, then make sure you enlist the help of a good accountant who can help.

- **Stay Organized**

Don't wait until April to try to get organized. Keeping good records year-round, staying organized, and filing papers properly can help save you when tax time hits. Having good records will help make filing taxes much easier, not to mention that should you run into issues in the future or are audited, you will have proper evidence to support your returns. Tips for staying organized include the following:

- Keep separate folders for each property. Keep all important and relevant documents separately. This will make it easier to keep track of your expenses and allow you to find relevant documents at a moment's notice.

- Scan your receipts into the computer and keep them in a folder. You can then file them away. This will save you from having to search for receipts when tax time rolls around.

- Have a separate checking account for your personal expenses and your rental activity. This will make it a lot easier to keep track of your finances and will simplify things when tax time comes as well.

- Keep all relevant receipts. Try to obtain documentation for every expense or transaction that occurs. It'll save you from having to try to remember things when tax time comes around. It's also important to make sure you keep receipts and records pertaining to the purpose of your trip, so that you can prove that you spent the majority of your time on rental-related tasks. Finally, when it comes to keeping receipts, make sure you separate your maintenance receipts from your improvements as well.

- **Track Your Expenses and Income**

Knowing what is deductible and what isn't is a good place to start when it comes to tracking expenses. By knowing your deductibles, you can better track your expenses to help make life easier come tax time. Tracking both your expenses and income is important when it comes to tax time, and starting now can help save you time and money, in the long run.

- **Keep Good Records**

Finally, keeping good records is essential year-round. Generally speaking, those who keep the best records are able to take the most deductions. Additionally, should the IRS decide to audit you, having airtight records will make life much easier and keep you out of trouble.

Pitfalls to Avoid

Being a new landlord or real estate investor comes with a whole host of new territory and things to learn and understand. When tax season comes around, it can be a very overwhelming experience! Knowing what to look for and what pitfalls a lot of new timers fall into can help save you time and money and a lot of frustration and stress. Here are a few common pitfalls to avoid when it comes to tax season for landlords and new investors.

- **Not Understanding Capital Improvements**

A big mistake that landlords often make around tax time is assuming that all work on the property is fully tax-deductible. But in the eyes of the IRS, not all work is the same. It's important for landlords to understand the difference between maintenance and repairs, which are tax-deductible, and things that are considered capital improvements. Capital improvements, as the name suggests, are things that improve the property beyond what was originally there. Things like new additions, restoring existing structures to "like new" conditions, upgrades that increase the property value are all capital improvements. On the flip side, repairs and maintenance that help keep the property in efficient operating condition, such as painting, repairing, and general maintenance are all considered repairs and maintenance that are tax-deductible. Understanding these differences now can help you better plan for repairs on your property as well as help you track your expenses more accurately and make tax season less stressful.

- **Assuming All Travel Expenses Are Deductible**

One of the perks of being a long-distance landlord is being able to deduct travel expenses. After spending so much money on travel, it can be nice to claim that as a deduction. However, many people confuse this deduction as a catch-all for everything travel-related, which can cause you to be flagged by the IRS and possibly audited.

According to the IRS' website:

"You can deduct the ordinary and necessary expenses of traveling away from home if the primary purpose of the trip is to collect rental income or to manage, conserve, or maintain your rental property. You must properly allocate your expenses between rental and nonrental activities. You can't deduct the cost of traveling away from home if the primary purpose of the trip is to improve the property. The cost of improvements is recovered by taking depreciation."

- **Not Understanding Deductions That Are Available**

Another common pitfall for landlords, is not taking advantage of deductions. There are a number of deductions available for landlords, and passing them up can mean that you'll end up leaving money on the table. Learning about the deductions that are available to you, and keeping good records, can help you to save.

- **Failing to Employ Tax-Saving Strategies**

Following on from neglecting to take available deductions is failing to employ tax-saving strategies when buying or selling a rental. Tax planning can help you to minimize or offset large, taxable gains so it's worth employing these strategies or reaching out to a good accountant who will be able to help you reduce your tax bill. Planning ahead is key, so don't wait until the last possible minute. Instead, give yourself time and reach out early on so you'll have time to implement the strategies.

Year End Tax Strategies

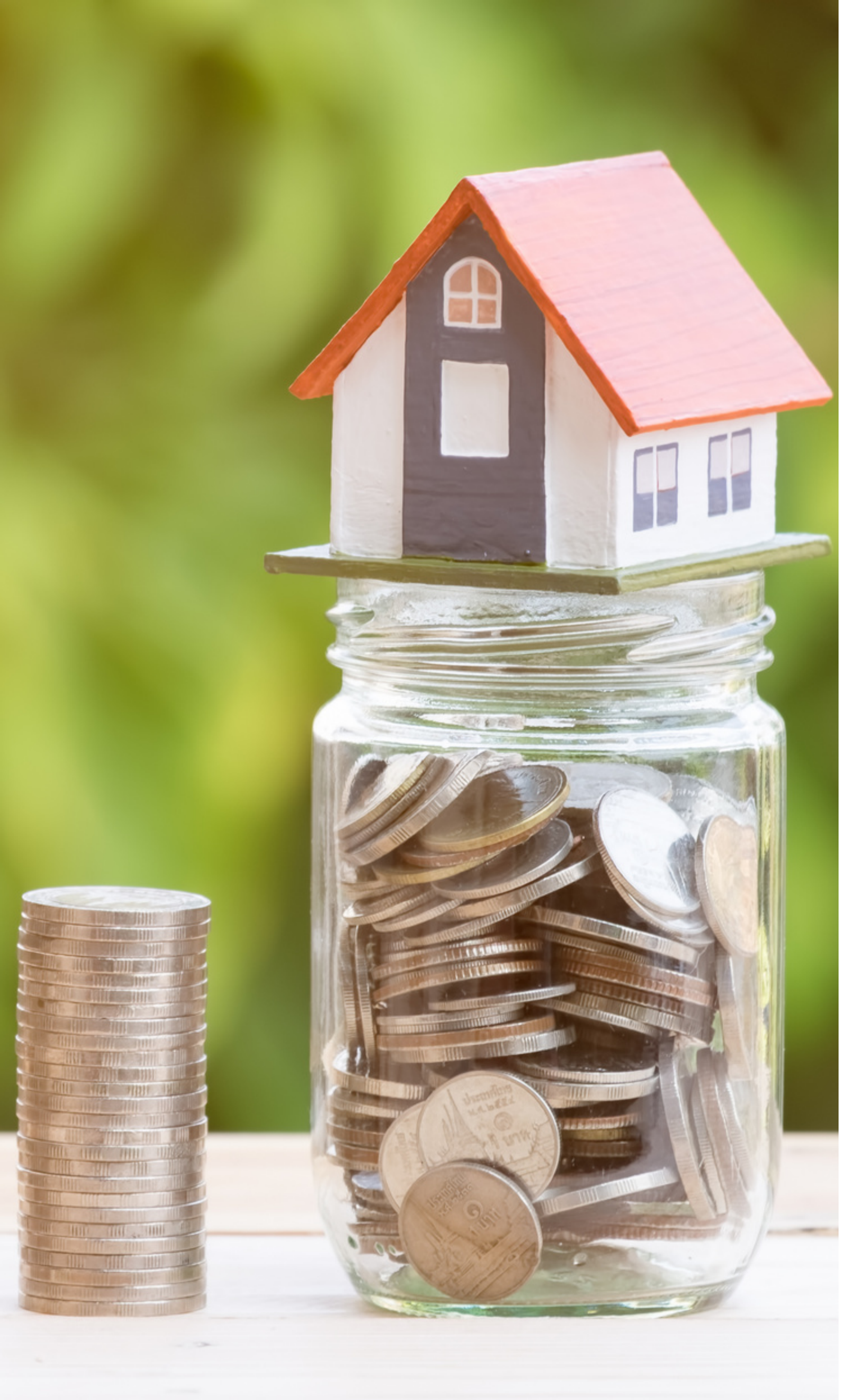
When the year starts to come to an end there are a number of things that you can do to lower your tax bill.

Since things must be completed in the year in which the tax is due, the end of the year tends to be a busy time for landlords as they rush to find things that can help benefit them come tax time. For investors, there's a big difference between Dec 31 and Jan 1, so make sure you employ the strategies that can help you to reduce your tax bill before the start of the year.

With this in mind, here are a few things that can help you to save on the amount of tax you owe.

- **Do Repairs**

If you've been putting off repairs, squeezing them in before the end of the year could save you come tax time. If you're hoping for the biggest tax breaks, just make sure the repairs you are doing are considered maintenance or repairs, and not improvements. While repairs can be deducted in the year that they were made, improvements must be depreciated –so they can be claimed over a number of years instead of all at once. Make sure you keep track of all the supplies you use as well as the time you spend. Or keep receipts from contractors, so you'll have something to back up your repairs in case you need to provide proof.



- **Contribute to a 401(k)**

Another good way to save at tax time is by contributing the maximum amount allowed to your 401(k). This is especially valuable if you have an employer who will match your contributions. However, contributing the maximum amount before the year is over is a good strategy to save on taxes during the year. This enables you to defer the taxes until you retire or when you withdraw the funds. The reasoning is that at that point, when you retire, you'll have a lower income than you do now and will be in a lower tax bracket, so the amount you'll end up paying in tax will, in that case, be lower. For 2021, you could have stashed away $19,500 per year into an account. In 2022, this amount rises to $20,500.

- **Check Your Deductions**

If you haven't been tracking them throughout the year, now would be a good time to check in on your deductions and see if there is anything else that you might be eligible for. On the other hand, you may want to consider holding off on some deductions so that you can use them next year. For instance, if you already have enough deductions for maintenance and repairs, then you might consider putting some of those repairs off until the next year.

- **Donate to a Charity**

Another last-minute deduction could be to donate to a charity. It is a quick and easy way to get a deduction, all while doing something charitable. Just make sure you get your donations in before the end of the year. Time spent volunteering for a charity is not tax-deductible, however, some expenses resulting from the volunteering, including mileage, parking and tolls, trips, and more, can also be claimed.

See more end-of-year tax strategies that you can employ.

What Happens if You Sell a Rental?

If you're thinking of selling a rental, don't forget to keep taxes in mind as well. When you sell a rental property, in most cases, you will need to pay taxes on the profits you make. The IRS taxes the profit that you make when selling your rental in two ways:

- Capital gains tax: A rate of 0%, 15%, or 20% depending on your filing status and taxable income
- Depreciation recapture: Tax rate of 25%

Here are a few ways you can offset the tax you will incur.

- **Do a 1031 Exchange**

A 1031 exchange allows you to sell one property and buy another "like-kind" property, without having to pay capital gains tax. The 1031 tax code essentially allows you to sell one property and buy another. Don't let the name "like-kind" confuse you. You can exchange a residential property for a commercial one, or vice versa if you'd like. You have a total of 45 days to make the purchase and 180 days to close on the property. It also has to be another property that's a similar value. If, for example, you "exchanged" a $300,000 property for a $250,000 one, then you'd owe taxes on the $50,000.

One of the great things about a 1031 exchange is that it allows you to reset depreciation. While depreciation is something that you'll need to recapture, and pay, when you sell your property, a 1031 exchange allows you to carry over the deprecation into the new property and defer it until a taxable sale of the replacement property occurs.

Learn more about the benefits of a 1031 exchange.

- **Consider Living in Your Rental**

Before selling, you might consider living in your rental first. If you live there for at least two years before selling, the IRS will consider it a residential home and not a rental property.

While this isn't an option for everyone, for the right situation, it can be a good way to avoid having to pay extra tax. When you sell a house that you've used as your primary residence, the profit that you make on the sale is usually tax-free –at least at the federal level. You may still owe state tax depending on your state.

Generally, you can make a $250,000 (if single) and $500,000 (if married) profit without owing taxes on the sale, as long as you've owned the house for at least two years and have lived in it for two of the past five years.

If you plan to sell, but aren't in a rush, then it might be wise to discuss your decision with a tax professional to determine which deductions you can claim and how you could best go about selling and claim deductions to help offset the costs.

- **Consider State Taxes**

Different states have different tax codes. To get a complete picture of how much you'll owe in state tax when you sell, make sure you contact the tax department of the state where your rental property is.

- **Consider Tax-Loss Harvesting**

Here's a strategy that's often used by stock market investors, but you may be able to use it for a rental property as well. With this strategy, you offset the gain that you've made with one investment by the loss of another. So if you had a taxable gain of $30,000 from a rental, and you sold money-losing stocks for a loss of $20,000, you could reduce your taxable gain to just $10,000. Of course, this strategy assumes that you have a significant amount of underperforming stocks just sitting around waiting to be sold. Still, it's worth bearing in mind. Learn more about tax-loss harvesting.

Conclusion

Owning rental properties can be a great way to grow your wealth. But don't overlook your annual expenses, like federal taxes. Familiarizing yourself with deductions that you can take as well as tax strategies that can help you to save, can make a big difference to your profitability at the end of the year. It's also important that you don't wait until the last minute to try to figure out your taxes. Keeping good records can make life easier, and can open up the door to more deductions as well.

Being a landlord can be a full-time job. And when you add taxes to the equation, this is certainly the case. The good news, though, is that you don't have to do it yourself. Rental income CAN be passive income. But only when it's done right. Most aspects of rental management can be outsourced, that includes –not only property management but accounting as well. Outsourcing your taxes to an experienced accountant –ideally, someone who's experienced in preparing taxes for landlords, means that you'll be able to save time, reduce stress, and enjoy focusing your attention on other things. A good accountant will also be able to alert you to things that you can do to save on your taxes, including deductions that you may have overlooked, helping you to save when tax time rolls around.

Looking to expand your real estate portfolio? Be sure to take a look at our inventory of rentals that are available for sale. Many of them are ready to go and complete with tenants.

Please Note: This information is intended to inform and to guide. It is not meant to serve in place of tax advice from a licensed tax professional. Please consult a tax professional to see how the tax law applies to your individual situation and to see which tax strategies you can employ as well as deductions that you may be able to take.