RentersWarehouse®

Are You Ready for Tax Season?

GUIDE:

Year-Round Tax Strategies – What Every Investor Needs to Know

Introduction

No one likes tax time, but knowing the rules and deductions that are available for landlords can help you to make smart financial moves that will allow you to minimize your tax bill when tax time rolls around. In this guide, we'll uncover what every investor should know about tax deductions, year-round tax strategies that you can use, and what you can do to make tax time easier when it rolls around.

Tax season can cause much confusion and frustration, especially for investors. But it doesn't have to be that way. While tax season will never be a particularly enjoyable time of year, by putting in the effort now to make a plan and put some organization into place, you can save yourself the headache and hassle that haunts us every April.

The end of the year often spells panic for landlords, as it means that landlords and all U.S. taxpayers only have a few more weeks to employ tax strategies that can make a difference on their upcoming tax bills.

While this year may have just started, it is never too early to begin to implement strategic plans that can help with tax breaks at the end of the year. Learning about tax deductions and tax strategies can help you plan your year out in a way that will help you to save come tax season.

Keep in mind that it isn't uncommon for profitable landlords to show a loss when it comes to their taxes. This is because there are many different tax opportunities for landlords to take advantage of during tax season. However, it is important to understand the details to help ensure you are following the regulations. Analyzing the particulars now can help save you from a big headache at the end of the year as you scramble to wrap things up, and again at tax time when you're rushing to file.

In this guide, we'll take a look at what you should know as a landlord, and highlight some tax deductions that you may be eligible for, which can help to help lower your tax bill. We'll also explore depreciation and show you why it's often the biggest part of reducing your tax bill.

What Counts as Rental Income?

First of all, it's important to realize that there are multiple sources of income that could be considered rental income, not simply the rent you collect.

In short, rental income is any payment you receive in exchange for the use of the property. According to the IRS, rental income is "any payment you receive for the use or occupation of property." This can come in the form of money or even services. It is important that you report any and all income for your rental property.

Here are some of the more common forms of rental income:

- **Rent Payments**
  Obviously, the payments you receive from your tenants as rent are to be included as income. This includes all forms of rent payments such as check, cash, or bank transfers. Regardless of how this payment is received, you need to declare all rental income on your taxes.

- **Expenses Paid by Tenants**
  If your tenant is not required to pay for certain services but pays them as part of their rent, that also qualifies as income and must be claimed on your taxes. While some of these expenses can be deducted, you still must include them in your general income. This could include emergency repairs or services as well.

- **Services Traded for Money**
  If a tenant agrees to work to pay part of their rent, this is still considered income, and the amount that they "worked off" must be claimed as income as well. Just because you didn't exchange money, doesn't mean you can ignore it as it is con-sidered registered income.

- **Security Deposits That You Keep**
  While the portion of the security deposit that you return to your tenant is not considered income, any portion that you keep must be included. This means if you keep part or all of the security deposit during the year to cover unpaid rent or damages, you would include that amount as income during the year.

Deductions for Landlords

While taxes aren't due until April 15, getting a head start is never a bad thing. Starting early will help you carefully narrow down what decisions will impact your tax bill, such as determining what fiscal year you should try to fit expenses into. And of course, remember to keep good records. All receipts should be kept in a safe place, ready for when tax time rolls around.

As a landlord, there are many deductions available that you may be eligible for. Applying these deductions can often help offset your income and give you a well-earned break come tax time.

Here are some deductions that landlords may be eligible for:

- Interest
- Repairs and Maintenance
- Travel
- Insurance
- Taxes
- Professional Fees
- Legal Fees
- Utilities
- Depreciation
- Improvements

Let's take a look at the details to help you better understand if you qualify for these deductions.

- **Interest**
  This is the one time that landlords can actually appreciate interest! Interest can be a big deduction for landlords. Your mortgage interest, interest on loans that were acquired to repair your rental property, or interest on credit cards that were used for rental property activity can all be deducted.

- **Repairs and Maintenance**
  Maintenance and repairs, not to be confused with upgrades and improvement, can also be deducted from your taxes. Repairs that were done to your rental to keep the property in good condition can be deducted. This can include things such as fixing a leaky roof, replacing broken windows, or repairing a floor. All repairs and maintenance items are fully deductible in the year the repairs took place. Maintenance tasks, such as lawn care, snow removal, HVAC services, tree pruning, and other tasks are also fully deductible.

- **Upgrades**
  Upgrades are tax-deductible too, but they must be treated differently. Unlike repairs, which can be itemized and fully deducted in the year that they are incurred, upgrades must be "depreciated" and claimed back over a period of multiple years.

  The IRS is very clear about what improvements are. Anything that increases the value of your property is considered to be an improvement. While you can deduct a small portion of that expense in the year it occurred, the majority of these improvements and upgrades must be distributed over a number of years.

- **Travel**
  Being a long-distance landlord comes with its own unique set of challenges, one of which is traveling to perform repairs or check on your investment. Fortunately, there are some deductions that you can claim when it comes to travel related to your rental property.

  While the IRS allows you to deduct travel expenses related to your rental activity, it is important to pay special attention to what is considered a travel expense and what is not. Being overly generous with travel deductions could be a red flag to the IRS, and you may find yourself facing an audit.

These data points will help to provide good insight into the area you're thinking of investing in, and give you the information that you need to assess the profitability of prospective rental properties.

Still, there are plenty of travel expenses that you can deduct. Just make sure you keep good records and save your receipts.

Long-Distance Travel – For long-distance landlords, you can deduct travel expenses that occur when you travel to your rental to perform maintenance or repairs. You cannot, however, deduct travel when you are traveling to perform upgrades or improvements. The IRS also allows you to deduct travel expenses such as airfare, hotel costs, and 50% of meal expenses.

It is especially important to note that the IRS looks closely at deductions for overnight travel, so be sure to have proper records to back up your claim. It is also important that stay within the guidelines for travel deductions.

Local Travel – For local rental properties, you can deduct the gas, oil, and vehicle upkeep. Or you can use the standard mileage rate from the IRS and claim back a specific amount of mileage.

Read more about long-distance landlords here: Investing Outside Your Home City

- **Professional and Legal Fees**
  Whenever you hire a professional to help out with your rental, you can deduct those fees from your taxes. These professionals can include your property manager, attorney, or accountant if you have hired one.

Try to Identify an Emerging Market

- **Insurance Premiums**
  Insurance is an important part of owning a rental unit, but did you know it's also an important consideration during tax time as well? You can deduct the premiums from almost any insurance you have for your rentals. This includes insurance premiums for fire, flood, and liability. You can also deduct the insurance premiums for your workers' compensation and health insurance if you have employees that have been hired to help with your rental unit.

- **Taxes**
  Yes, taxes are tax-deductible! In some cases, that is. The various taxes you pay throughout the year are also considered deductible: property taxes, state and city taxes, taxes for employees such as unemployment or social security taxes. All these taxes, as long as they were related to your rental unit, are deductible.

- **Utilities**
  Any utilities that you pay for are able to be deducted. You can also deduct the utilities that your tenants have reimbursed you for. However, it's important to remember that that money needs to be included as income. Common utilities for rental units include electric, gas, sewer, water, and trash. Other utilities can include cable and internet, assuming you provide those to your tenants.

- **Contractors and Employees**
  Of course, any money you have paid out to hire contractors to help with repairs or maintenance on your rental, as well as wages paid to employees who you have hired to help with your rental company are also deductible. Don't forget to include those you have hired to help with maintenance or repairs. Everything from lawn care to snow removal is considered deductible.

- **Advertising Fees**
  While a good property manager will generally handle all the advertising and marketing for you, if you don't have a property manager or have paid for any expenses on your own, you can deduct these costs from your taxes as well. This includes anything from ads in the newspaper to yard signs.

The Pass-Through Deduction
As of 2018, most landlords are eligible for a pass-through deduction, which means that up to 20% of your rental income may be deductible. There are two requirements you must meet in order to qualify. First, your income must be below $163,300 if you are single, or $326,600 if you are filing jointly (for 2020). Secondly, you must operate your rental properties through a sole proprietorship, LLC, S corporation, trust, or estate. Keep in mind that this deduction is scheduled to end on January 1, 2026.

Do You Need a Property Manager? Hiring one could make your life as a landlord simpler!

Understanding Depreciation

Depreciation is another deduction, and often, it ends up being a landlord's most significant deduction as well.

The IRS assumes that a residential property has a 'useful life' of 27.5 years. For landlords, this means that you can greatly reduce your tax bill by claiming this deduction.

It's also important to keep in mind that certain items depreciate faster. Appliances, for instance, can only be depreciated over five years. Over the course of those years, you can claim depreciation as a deduction on your taxes.

However, there are guidelines you must follow when it comes to registering depreciation on your rental units. It is important that you follow these guidelines to ensure you are not only depreciating the correct amount but that you qualify for depreciation as well.

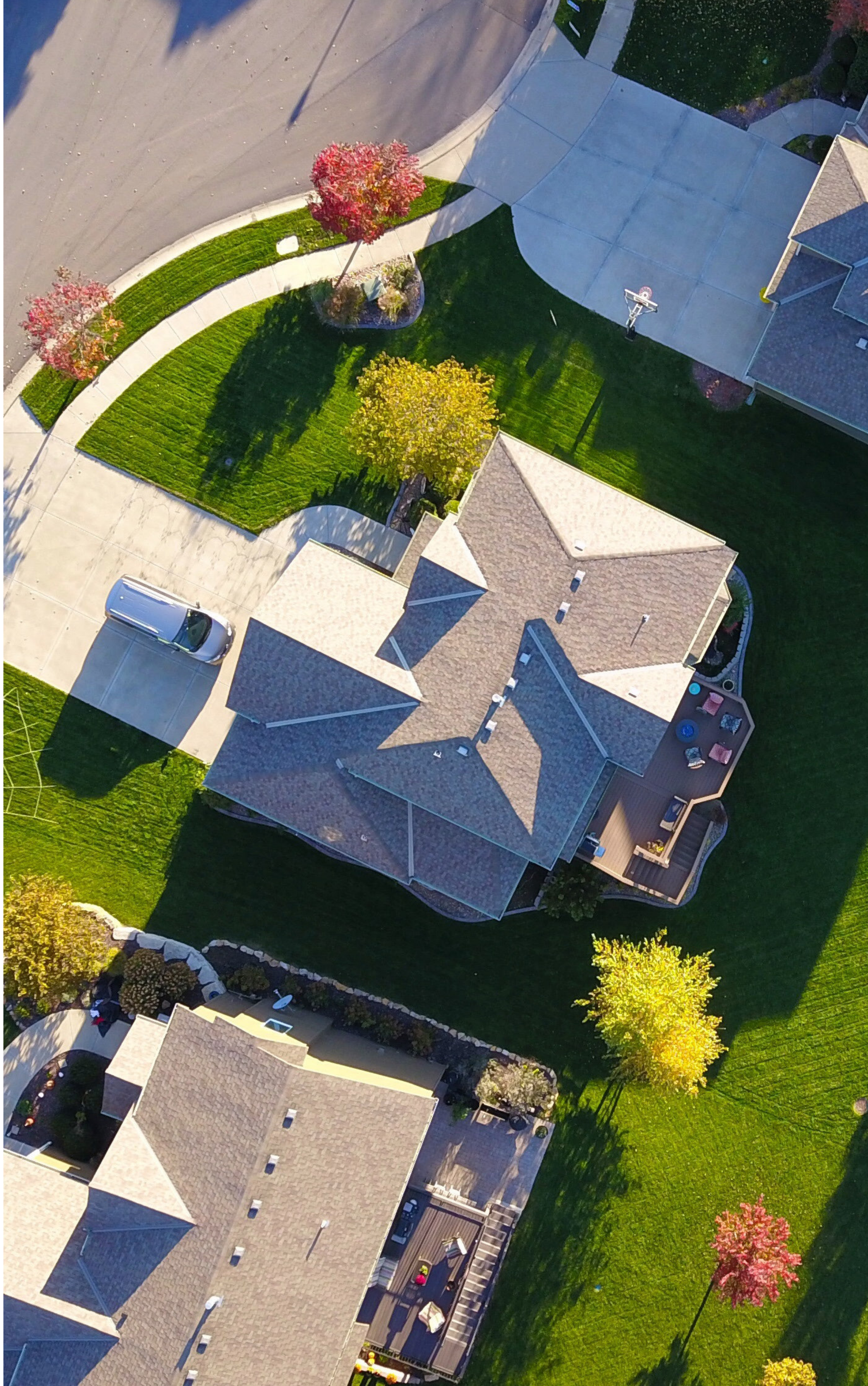
- **Depreciating Property**
  The IRS has very clear guidelines on depreciating your rental property. In order to be able to depreciate your rental property, you must first ensure that it meets all of the requirements that the IRS has laid out:
  1. ***You must own the property or must be considered the own-er of the property.***
  2. ***You must use the property for your business or as a source of income.***
  3. ***The property must have a determinable useful life.***
  4. ***The property is expected to last for more than one year.***

You must also keep in mind that you cannot depreciate your property if you bought and sold it within the same year, which means that those who perform fix-and-flip investments generally can't claim depreciation since they buy and sell within the year. You also cannot depreciate the cost of the property itself since land is never 'used up,' or loses value.

- **Depreciation Limits**
  Your depreciation deduction starts as soon as your property is ready to be placed in service, or is ready to start earning you an income. It will continue to depreciate until you have deducted the entire cost or you sell the property. Once you sell the property, the depreciation process starts over with the new owner.

  Finally, it's important to note that all depreciation must be "paid back" to the IRS in the form of depreciation recapture at the time of the property's sale. There are some exceptions, and one is using a 1031 exchange.

  Learn more about depreciation recapture here.



End of Year Strategies

It’s never too early to get a head start on taxes and being prepared ahead of time means you aren’t scrambling to meet a deadline down the line! Start to make a plan to help ensure you have everything ready for the end of the year. Here are a few strategies you should begin considering so when the end of the year comes, you’ll be ready to roll!

- **Deferring Your Income**
  Deferring your income is a tax strategy that allows you to defer paying taxes on some of your income. It is a strategy that is available for some investors, including real estate investors. Deferred income, also known as a 1031 Exchange, allows investors to use some income and ‘exchange’ it for a ‘like-kind’ asset. Don’t let the term “like-kind” fool you; you can exchange a single-family rental for a duplex, apartment building, or even land.

  For example, if you were to sell your duplex and buy another of similar size and value, you can defer the capital gains tax that comes with the property. The idea behind deferred income is that you will reinvest your money into more real estate instead of keeping the profits.

- **Plan Out Your Deductions**
  Another reason it is important to plan your tax strategy in advance is so that you can ensure you have enough deductions. If you have had a lot of deductions already for this year, you might consider postponing some for next year. You can also determine and budget for maintenance items that would be beneficial to you come tax season and plan those accordingly. Don’t wait until the year is almost over to remember you’d like to take advantage of these tax breaks then race to perform these actions. Start now!

- **Consider Donating to Charity**
  Feeling charitable? If you are looking for some last-minute deductions that you can benefit from, you might consider making a charitable contribution to your favorite charity. It doesn’t have to be real estate related; as long as you are making a donation to a charity, you can claim this as a deduction on your taxes. Just make sure you get your contribution in before the year is up.

- **Consider Selling Off Underperforming Investments**
  While a loss is never pleasant, if you have some underperforming investments that you have been looking to offload, you might consider doing so now. If you sell off at a loss, you can claim a capital loss on your taxes. This loss can help offset other investments that are performing well. Since losses offset gains dollar for dollar, they are an especially helpful deduction.

Final Tips to Ensure a Smooth Filing Process

Preparing to file your taxes should begin as soon as the year starts. This is so you aren’t rushing by December to get everything in order by the April 15th due date! While the process may seem daunting, here are some tips to help optimize your filing strategy.

- **Set a Budget**
  While setting a budget isn’t related specifically to tax season, it is important that you set (and follow!) a budget for your rental property. For tax purposes, it can be beneficial to see what areas you should focus on and what areas should wait until the following year. Keep in mind that there are limits to your deductions and if you have already budgeted to spend your limit in one area, you might see about focusing on another area to help balance things out.

It is important to remember that hiring a CPA can't ensure you have met your requirements or hit all the deduction categories for the year. It is still up to you to keep proper records and do the legwork leading up to the final processing. You may find it saves you time to hire out, especially if you're a landlord with multiple properties. You will find that hiring an accountant will be worth the money as things can get especially time-consuming with more than one property.

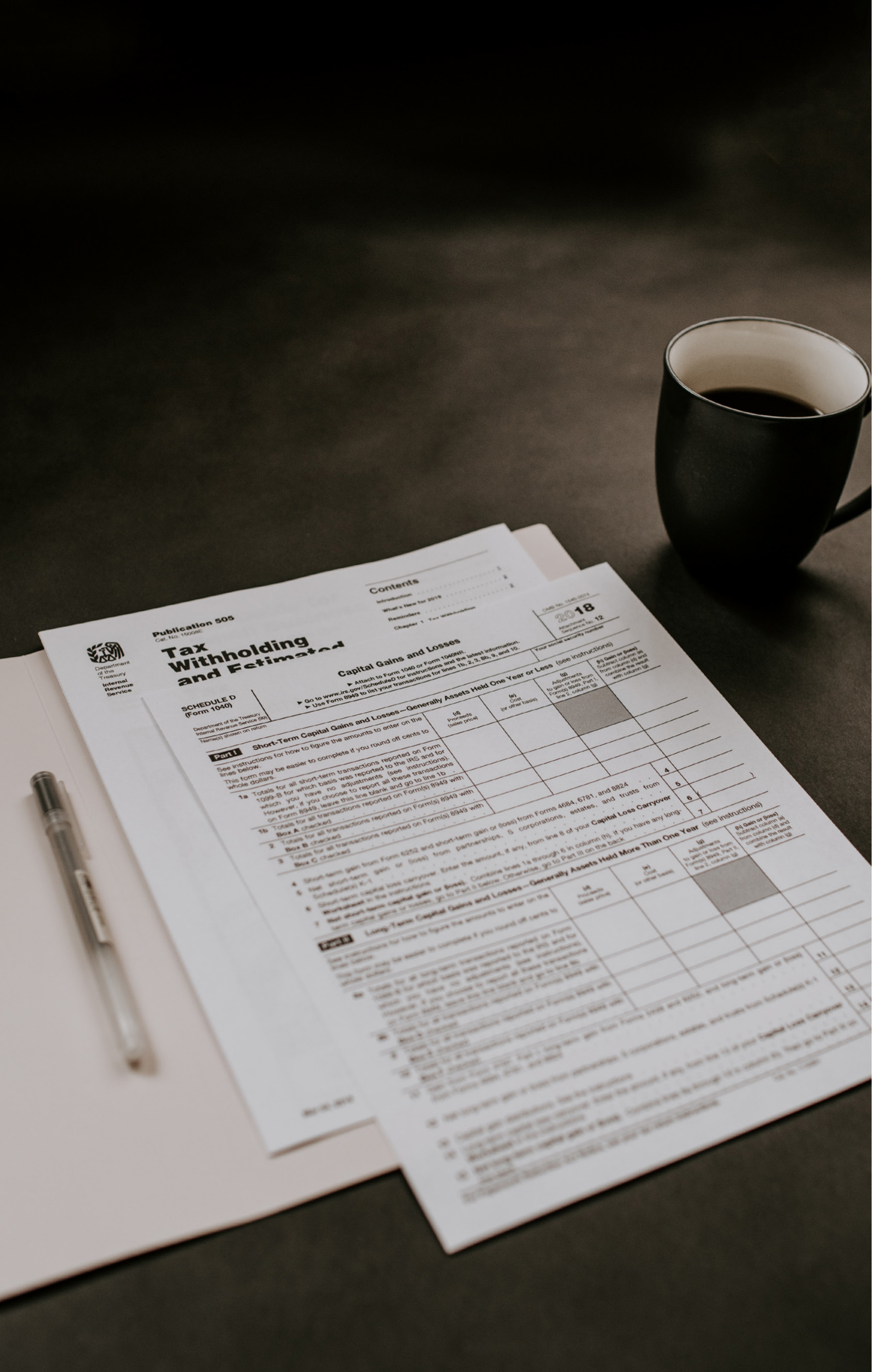
Need more year-end tax tips? End of Year Taxes – What Property Owners Need to Know

- **Get Organized**
  It might sound obvious, but it's often neglected. Organization is key when it comes to reducing your taxes. The better your recordkeeping, the better your deductions will be. Keeping track of your deduction items throughout the year will help you when tax time comes. This way,you will be able to quickly calculate your deductions and have receipts to back your claims. The best way to get organized is to create a system that works best for you. Anything from software to a spreadsheet to a file with all your receipts, the key is finding what works best for you and sticking to it.

- **Follow the Rules**
  Finally, ignoring the rules and being overly generous with your tax deductions will not do you any favors. In fact, even if you unintentionally make a mistake or file the wrong form, you could end up owing significant fees. It is important that you know the rules and understand what you are claiming. If you don't understand the regulations completely or aren't able to make sense of something, you should consider hiring an accountant.

- **Follow the Rules**
  Two common mistakes made with taxes is mixing up the numbers or not calculating figures correctly. It is important to double-check your numbers and ensure everything adds up correctly and is entered in right. This will help save you from having to amend your taxes after you have submitted them and could save you from having to pay fees.

- **Hire a Certified Public Accountant**
  Taxes are just another part of life. However, they may be an extra confusing part of your life now that you are a landlord! Handling your own taxes isn't for everyone. If this isn't an area that you are comfortable tackling, then you'll want to hire a CPA to handle things for you.



In Conclusion

Just because tax season rolls around once a year doesn't mean you have to wait until the deadline to start getting prepared. In fact, by taking the time now to set yourself up for the year ahead, you will find yourself less stressed and more prepared when tax season arrives again. And of course, by starting early, you'll be able to ensure you're taking full advantage of deductions and strategies that are available to you, helping to minimize your tax bill.

Taxes: believe it or not, it's one of the reasons that we love Rent Estate so much. With rental property, the IRS lets you deduct many expenses. More than traditional real estate. And that makes Rent Estate an attractive investment opportunity.

Note: This article is intended to inform and to guide. It is not meant to serve in place of tax advice from a licensed tax professional or attorney. Please consult a tax professional for information about your tax situation and deductions that you're eligible for.