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Income Property & Taxes – A "Primer"

Source: Federal IRS Publication 527

Income

- You must include in your gross income all amounts you receive as rent
- Rental income is any payment you receive for the use or the occupation of the property
- If a tenant pays any of your expense, the payments are considered rental income

Expenses

- **Depreciation:** The cost of income producing property is recovered through yearly tax deductions
  - → Depreciation may only be deducted on the part of your property used for rental purposes
  - → The three (3) primary factors affecting depreciation are:
    1) Your basis in the property
       a. The cost basis is the total amount you paid for the property, plus approved settlement fees and some closing costs
       b. Your cost basis may increase or decrease pending capital improvements, easements granted, etc.
    2) The depreciation method used
       a. Depreciation method: MACRS (Modified Accelerated Cost Recovery System for property placed in service after 1986
    3) The recovery period for the property
       a. The MACRS recovery period for residential rental property is 27.5 years

- **Repairs & Improvements:** You can deduct the cost of repairs to your rental property. You cannot deduct improvements. Capital improvement costs are recovered through depreciation.

- **Other Expenses:** Examples of additional expenses that may be deducted from your rental income are as follows:
  - → Advertising, cleaning & maintenance, utilities, insurance, property taxes, mortgage interest, points, commissions.

Limits on Rental Losses

- Rental real estate activities are generally considered passive activities and the amount of loss you can deduct against your active income is limited. (except for some Real Estate Professionals)
- If you or your spouse actively participated in a passive rental real estate activity, you can deduct up to $25,000 of loss against your active income, within the following limits:
  - → If you are married filing jointly, and your active modified adjusted gross income is $100,000 or less, you can deduct up to $25,000 rental activity loss.
  - → If you are married filing jointly, and your active modified adjusted gross income is greater than $100,000, you can only deduct up to 50% of the difference between $150,000 and $100,000.
  - → If you are married filing jointly, and your active modified adjusted gross income is greater than $150,000, you generally cannot deduct any rental activity losses.

Losses Carried Forward

- Any excess losses may be carried forward to the following year or years until used, or until deducted in the year you dispose of your entire interest in the activity in a fully taxable transaction.

We recommend that you always check with your Accountant or C.P.A. before making any important Tax decisions!