

# UNDERSTANDING RENTAL INCOME AND EXPENSES FOR TAX PURPOSES

Whether you're new to renting out property or just need a refresher, understanding the tax rules for rental income and expenses can help you stay compliant and maximize your deductions. Below is a breakdown of common types of rental income, allowable expenses, and tips for handling them properly.

## Types of Rental Income

- **Advance Rent**

- Rent received before it's due is considered income in the year you receive it, even if it applies to future years.
- Example: In 2024, you sign a 10-year lease and collect \$9,600 for the first year and \$9,600 for the final year upfront. You must report \$19,200 as income in 2024.

- **Lease Cancellation Payments**

- Payments from tenants to cancel a lease are considered rental income for the year they are received.

- **Expenses Paid by Tenants**

- If a tenant pays a property-related expense on your behalf (e.g., utility bills or repairs), the payment counts as rental income. However, you can also deduct those expenses as rental expenses.
- Example: A tenant pays for furnace repairs and deducts the cost from their rent. You report the repair cost as income but also deduct it as an expense.

- **Property or Services as Rent**

- If a tenant provides services or goods instead of cash for rent, you must report the fair market value (FMV) of those services or goods as rental income.
- Example: A tenant paints your property instead of paying two months' rent. You report the FMV of the rent you would have received and deduct the painting expense.

- **Security Deposits**

- Security deposits are not included as income if you intend to return them. If you keep any portion (e.g., for unpaid rent or damages), it must be included as income in the year it is retained.

- **Other Sources of Rental Income**

- Lease with an option to buy: Payments are rental income until the tenant exercises the option to purchase.
- Part ownership: If you co-own a property, report your share of the income and expenses.
- Short-term home rentals (under 15 days): If you rent out your home for fewer than 15 days per year, you do not need to report the income or expenses.

## Rental Expenses

- Many costs related to maintaining or operating your rental property are deductible, including:
- Advertising
- Cleaning and Maintenance
- Depreciation (including cost segregation)
- Homeowners Insurance
- Umbrella Insurance
- Mortgage Interest
- Legal and Professional Fees (including cost segregation analysis)
- Repairs and Maintenance (including safe harbors under the Tangible Property Regulations)
- Real Estate Taxes
- Utilities

## Special Notes on Expenses

- **Personal Use of the Property**
  - If you use the property for personal purposes (e.g., as a vacation home), expenses must be allocated between personal and rental use.
  - If personal use exceeds 14 days or 10% of total rental days, the property is no longer classified as a rental property for tax purposes.
- **Shared Ownership**
  - For co-owned properties, deductions are based on your ownership percentage.
  - Example: If you own 50% of a property, you can only deduct 50% of the expenses.

