Biz Facts

Just the facts about your taxes!

Business by Design

Featuring: myBBDPass

BIZ Points for Real Estate Rentals (Pub 527)

RENTAL INCOME:

Advanced Rent

- Any amount you receive before the period that it covers. Include in income when received. You sign a 10-year lease and receive first and last payment. Include both in income the first year.

Security Deposits

- Not included if returned to tenant. Deposits not returned are added to income in that year.

Payment for Canceling a Lease

- Included in income when received.

Expenses Paid by Tenant

- Tenant paid expenses are rent income.

Property or Services

- If you receive property or services, instead of money, as rent, include as FMV of the property or services in your rental income.

Lease with Option to Buy

- The payments you receive are generally rental income. If your tenant exercises the right to buy the property, the payments you receive after the date of sale are considered part of the selling price.

Rental of Home

- If you rent property that you also use as your home and you rent it fewer than 15 days during the tax year, do not include the rent you receive in your income and do not deduct rental expenses.

Part Interest

- If you own a part interest in rental property, you must report your part of the rental income from the property.

*This information should be used as a guideline. Specific questions regarding this “Biz Facts” should be directed to a Business by Design tax professional.

RENTAL EXPENSE:

When to Deduct

- You generally deduct your rental expenses in the year you pay them.

Pre-Rental Expenses

- You can deduct your ordinary and necessary expenses for managing, conserving, or maintaining rental property from the time you make it available for rent.

Depreciation

- You can depreciate rental property when it is ready and available for rent. Placed-in-service. SEE BIZ FACTS-DEPRECIATION OF REAL ESTATE.

Personal Use of Rental Property

- If you sometimes use your rental property for personal purposes, you must divide your expenses between rental and personal use.

Part Interest

- If you own a part interest in rental property, you can deduct your part of the expenses that you paid.

Repairs

- A repair keeps your property in good operating condition. It does not materially add to the value of your property or substantially prolong its life. Repainting your property inside or out, fixing gutters or floors, fixing leaks, plastering, and replacing broken windows are example of repairs. If you make repairs as part of an extensive remodeling or restoration of your property, the whole job is an improvement.

Improvements

- An improvement adds to the value of property, prolongs its useful life, or adapts it to new uses.

Insurance Premiums Paid in Advance

- If you pay an insurance premium for more than one year in advance, each year you can deduct the part of the premium payment that will apply to that year. You cannot deduct the total premium in the year you pay it.

Local Benefit Taxes

- Generally, you cannot deduct charges for local benefits that increase the value of your property, such as charges for putting in streets, sidewalks, or water and sewer systems. You must add them to the basis of your property. You can deduct local benefit taxes if they are for maintaining, repairing, or paying interest charges for the benefits.

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Expenses Paid to Obtain a Mortgage

- Certain expenses you pay to obtain a mortgage on your rental property cannot be deducted as interest. These expenses, which include mortgage commissions, abstract fees, and recording fees, are capital expenses. However you amortize them over the life of the mortgage.

Points

- The term “points” is often used to describe some of the charges paid by a borrower to take out a loan or a mortgage. These charges are also called Loan Origination Fees, maximum loan charges, or premium charges. If any of these charges (points) are solely for the use of money, they are interest.

Loan or Mortgage Ends

- If your mortgage ends, deduct any remaining points in the tax year in which the loan or mortgage ends.

Travel Expenses

- You can deduct traveling away from home if the primary purpose of the trip was to collect rental income or to manage, conserve, or maintain your rental property. You must keep records including date, mileage, destination and purpose.

Section 179 Deduction

- You cannot claim the section 179 deduction for property held to produce rental income.

Depreciation Basis

- The depreciable basis of property used in a rental activity is generally its adjusted basis when you place it in service in that activity. This is its cost or other basis when you acquired it, adjusted for certain items occurring before you place it in service in the rental activity.

Assumption of a Mortgage

- If you buy property and become liable for an existing mortgage on the property, your basis is the amount you pay for the property plus the amount that still must be paid on the mortgage.

Land/Buildings

- If you buy buildings and your cost includes the cost of land on which they stand, you must divide the cost between the land and the buildings to figure the basis for depreciation of the buildings. The part of the cost that you allocate to each asset is the ratio of the fair market value of that asset to the fair market value of the whole property at the time you buy it. If you are not certain of the fair market values of the land and the buildings, you can divide the cost between them based on their assessed values for real estate tax purposes.

Basis of Property Changed to Rental Use

- When you change property you held for personal use to rental use, you figure the basis for depreciation using the lesser of fair market value or adjusted basis. Fair Market Value is the price at which the property would change hands between a buyer and seller, neither having to buy or sell, and both having reasonable knowledge of all the relevant facts. Sales of similar property, on or about the same date, may be helpful in figuring the fair market value of the property.

Casualty

- Damage to, destruction of, or loss of property is a casualty if it results from an identifiable event that is sudden, unexpected, or unusual.

Theft

- The unlawful taking and removing of your money or property with the intent to deprive you of it is a theft.

Gain from Casualty or Theft

- When you have a casualty to, or theft of, your property and you receive money, including insurance that is more than your adjusted basis in the property, you generally must report the gain. However, under certain circumstances, you may defer paying tax by choosing to postpone reporting the gain. To do this, you must generally buy replacement property within 2 years after the close of the first tax year in which any part of your gain is realized. The cost of the replacement property must be equal to or more than the net insurance or other payment you received.

Tax Trap

- Renting property to a business you materially participate (500 Hours).
    - Real Estate Rental (Office)
        - Income is not passive-No SE Tax
        - Loss is passive
    - Personal Property
        - Income is not passive-SE Tax
        - Loss is passive-No SE Tax

Home Office Deductions

- IRS Technical Assistance 200121070, reiterates that if the S corporation pays the sole shareholder rental income for the use of the portion of the home used as an office for the employee/shareholder, the S corporation deducts the rental expense and the

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shareholder reports the income on Schedule E. Only the interest and taxes portion may than be deductible.

Debt Basis

- RECOURSE DEBT is defined under Reg. 1.752-1(a)(1) as " A partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss for that liability."
    1) Economic risk of loss means that the partner or member would be legally obligated to make payments, directly or indirectly, to satisfy the liability out of his non-partnership assets if the partnership had no assets to pay liabilities that were due.
    2) If the LLC/Partnership had no assets to pay liabilities that were due.
- NONRECOURSE DEBT is defined under Reg. 1.752-1(a)(2) as " A partnership liability is a non-recourse liability to the extent that no partner or related person bears the economic risk of loss for that liability". (NOT AT RISK)
- QUALIFIED NON-RECOURSE FINANCING is financing secured by real property and loaned or guaranteed by:
    - A governmental agency
    - Banks or others actively engaged in lending
    - Does not include contract sales, related party loans or agent of seller
    - Partner and partnership must meet qualified non-recourse rules
    - Financing is allocated based upon the profit sharing agreement