TAX IMPLICATIONS & BENEFITS OF HOLDING A RENTAL PROPERTY

By Margaret Flowers, CPA

When discussing investments, you may often hear the term *diversify*. One of the ways to diversify your portfolio is to invest in real estate investment properties. Whether you convert your main residence to a rental property or buy a property to be held as a rental, there are several tax considerations to be aware of.

Reducing Income With Expenses

The rental income that you receive is taxable income, but you can reduce that income by the expenses of the property. For example, if you collect rental income of $12,000 but have expenses of $10,000, you will pay tax on the $2,000 profit. If the income less expenses results in a loss, you may be able to deduct up to $25,000 in losses against your ordinary income, depending on your income. If your income is over $100,000 for a married filing joint return ($50,000 for single), your allowed deduction begins to phase out and is phased out completely at $150,000 ($75,000 for single filers). If you are unable to deduct the loss, it will carry over until the property generates positive income or your income is below the limits.

What type of expenses are allowed against rental income? The most common expenses you generally see on rental properties are landlord insurance, mortgage interest, property taxes, utilities, repairs, cleaning and maintenance, depreciation and amortization. The mortgage payment usually includes a portion that applied to principal. Since this is a debt payment and lowers your mortgage balance, this portion of the payment is not deductible. Renovations to the property will be capitalized and depreciated over time instead of deducted immediately. Residential properties will be depreciated over 27.5 years while commercial rental properties will be depreciated over 39 years.

Usually rental properties will generate positive cash flow while creating a tax loss due to the depreciation of the property. After about 10-15 years, the depreciation will be lower and the property should create positive taxable income. Many taxpayers enjoy the tax benefit of deducting the loss while creating a positive stream of cash flow.

Recent Tax Law Changes

On December 21, 2017, President Trump signed the Tax Cuts and Jobs Act which included a provision for a deduction for 20% of all pass-through income. Rental income is included in this deduction if it rises to the level of a trade or business. Consult your tax professional to discuss the requirements for this deduction.

If you have any questions, please contact our office and we would be happy to discuss how owning a rental property may impact your tax return.

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