

Rental Property Tax Basics

EMRYS TAX ADVISORS

Rental property offers some of the best tax advantages available under the U.S. tax code. Understanding depreciation, passive loss rules, and special elections can dramatically reduce your tax liability.

Depreciation

Residential rental property is depreciated over 27.5 years using straight-line depreciation. This means you can deduct a portion of the property's value each year—even if the property is appreciating in market value. Depreciation is often the largest single deduction for rental property owners.

Example: A rental property with a building value of \$275,000 generates \$10,000/year in depreciation deductions—regardless of whether the property earns or loses money.

Deductible Expenses

Common deductible expenses include: mortgage interest, property taxes, insurance, repairs and maintenance, property management fees, advertising, utilities paid by the owner, and depreciation. Capital improvements (new roof, HVAC, additions) are not immediately deducted—they are depreciated over time.

Passive Loss Rules

Rental losses are generally classified as passive losses, which can only offset passive income. However, if your adjusted gross income (AGI) is \$100,000 or less, you may deduct up to \$25,000 of rental losses against ordinary income. This phases out between \$100K–\$150K AGI.

Short-Term Rentals (STR)

If average guest stays are 7 days or fewer, the property may be treated as a non-passive activity if you materially participate. This can unlock much larger deductions against ordinary income—but the rules are specific and documentation is essential.

1031 Exchange

A 1031 exchange allows you to defer capital gains taxes when selling a rental property, as long as you reinvest the proceeds in a like-kind property within strict timeframes: 45 days to identify the replacement property, 180 days to close.