PacificCPE

COURSE

34051B

Residential Rental Properties: Tax Fundamentals

A solid grounding in residential rental taxation, this course covers the full lifecycle of rental income and expenses, including depreciation, loss reporting, and the safe harbor election for small taxpayers. It also addresses special situations and the often-tricky rules around personal use of a dwelling unit, including vacation homes. Whether you're new to rental property returns or looking to sharpen your skills, this course lays the foundation for accurate and confident client advising.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

Start Course ↓

Final Exam Copy ↓

LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize how to report rental income and expenses, including depreciation, on the return.
-

Recognize proper handling of casualty losses for residential rental property.

- Identify the passive activity and at-risk rules related to residential rental property.

Copyright Notice

© 2026 Pacific CPE, LP. All rights reserved.

The materials in this course — including the text, illustrations, exhibits, examples, exam questions, and review questions — are the copyrighted property of Pacific CPE, LP. No portion of this course may be reproduced, stored in a retrieval system, distributed, or transmitted in any form or by any means (electronic, mechanical, photocopying, recording, or otherwise) without the prior written permission of Pacific CPE, LP, except for the personal, non-commercial use of the registered learner.

Pacific CPE, LP grants the registered learner a single-seat, non-transferable license to access this course for the purpose of completing the associated continuing professional education credit. Account credentials may not be shared. Group access requires a separate enterprise license.

This course is provided "as is" for educational purposes. While Pacific CPE, LP makes a reasonable effort to ensure the content is current and accurate, the materials should not be relied upon as a substitute for professional advice. Pacific CPE, LP disclaims all liability for any error, omission, or loss arising from the use of, or reliance on, the course content.

Questions about reproduction, licensing, or use of these materials should be directed to support@pacificcpe.com.

Publication Date: April 2026

TABLE OF CONTENTS

CHAPTER 00

Introduction 5

0.01 I. Reminder 5

0.02 A. Trade Or Business Safe Harbor - Rental Real Estate 5

CHAPTER 01

Residential Rental Property (Including Rental Of Vacation Homes) 7

1.01 I. Rental Income 7

1.02 II. Rental Expenses 9

1.03 III. Depreciation Of Rental Property 19

1.04 IV. Reporting Rental Income, Expenses, And Losses 42

1.05 V. Special Situations 53

1.06 VI. Personal Use Of Dwelling Unit (Including Vacation Home) 62

Test Your Knowledge 75

Final Exam Copy 82

Index .....

INTRODUCTION

I. REMINDER

A. TRADE OR BUSINESS SAFE HARBOR - RENTAL REAL ESTATE

The Internal Revenue Service issued Revenue Procedure 2019-38 that has a safe harbor allowing certain interests in rental real estate, including interests in mixed-use property, to be treated as a trade or business for purposes of the qualified business income deduction under section 199A of the Internal Revenue Code (section 199A deduction).

If all the safe harbor requirements are met, an interest in rental real estate will be treated as a single trade or business for purposes of the section 199A deduction. If an interest in real estate fails to satisfy all the requirements of the safe harbor, it may still be treated as a trade or business for purposes of the section 199A deduction if it otherwise meets the definition of a trade or business in the section 199A regulations.

This safe harbor is available for taxpayers who seek to claim the section 199A deduction with respect to a “rental real estate enterprise.” Solely for purposes of this safe harbor, a rental real estate enterprise is defined as an interest in real property held to generate rental or lease income. It may consist of an interest in a single property or interests in multiple properties. The taxpayer or a relevant passthrough entity (RPE) relying on this revenue procedure must hold each interest directly or through an entity disregarded as an entity separate from its owner, such as a limited liability company with a single member.

The following requirements must be met by taxpayers or RPEs to qualify for this safe harbor:

- Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise.
- For rental real estate enterprises that have been in existence less than four years, 250 or more hours of rental services are performed per year. For other rental real estate enterprises, 250 or more hours of rental services are performed in at least three of the past five years.
- The taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding the following: hours of all services performed; description of all services performed; dates on which such services were performed; and who performed the services.

- The taxpayer or RPE attaches a statement to the return filed for the tax year(s) the safe harbor is relied upon.

Chapter 1: RESIDENTIAL RENTAL PROPERTY (INCLUDING RENTAL OF VACATION HOMES)

Chapter Objective

After completing this chapter, you should be able to:

- Recognize how to report rental income and expenses, including depreciation, on the return.
- Recognize proper handling of casualty losses for residential rental property.
- Identify the passive activity and at-risk rules related to residential rental property.

I. RENTAL INCOME

In most cases, you must include in your gross income all amounts you receive as rent. Rental income is any payment you receive for the use or occupation of property. It is not limited to amounts you receive as normal rental payments.

WHEN TO REPORT

When you report rental income on your tax return generally depends on whether you are a cash basis taxpayer or use an accrual method. Most individual taxpayers use the cash method.

Cash method. You are a cash basis taxpayer if you report income on your return in the year you actually or constructively receive it, regardless of when it was earned. You constructively receive income when it is made available to you, for example, by being credited to your bank account.

Accrual method. If you are an accrual basis taxpayer, you generally report income when you earn it, rather than when you receive it. You generally deduct your expenses when you incur them, rather than when you pay them.

TYPES OF INCOME

The following are common types of rental income.

Advance rent. Advance rent is any amount you receive before the period that it covers. Include advance rent in your rental income in the year you receive it regardless of the period covered or the method of accounting you use.

Example

On March 18, 2025, you signed a 10-year lease to rent your property. During 2025, you received $9,600 for the first year's rent and $9,600 as rent for the last year of the lease. You must include $19,200 in your rental income in 2025.

Canceling a lease. If your tenant pays you to cancel a lease, the amount you receive is rent. Include the payment in your income in the year you receive it regardless of your method of accounting.

Expenses paid by tenant. If your tenant pays any of your rental expenses, those payments are rental income. Because you must include this amount in income, you can also deduct the expenses if they are deductible rental expenses. For more information, see Rental Expenses, later.

Example 1

Your tenant pays the water and sewage bill for your rental property and deducts the amount from the normal rent payment. Under the terms of the lease, your tenant does not have to pay this bill. Include the utility bill paid by the tenant and any amount received as a rent payment in your rental income. You can deduct the utility payment made by your tenant as a rental expense.

Example 2

While you are out of town, the furnace in your rental property stops working. Your tenant pays for the necessary repairs and deducts the repair bill from the rent payment. Include the repair bill paid by the tenant and any amount received as a rent payment in your rental income. You can deduct the repair payment made by your tenant as a rental expense.

Property or services. If you receive property or services as rent, instead of money, include the fair market value of the property or services in your rental income.

If the services are provided at an agreed upon or specified price, that price is the fair market value unless there is evidence to the contrary.

Example

Your tenant is a house painter. He offers to paint your rental property instead of paying 2 months' rent. You accept his offer.

Include in your rental income the amount the tenant would have paid for 2 months' rent. You can deduct that same amount as a rental expense for painting your property.

Security deposits. Do not include a security deposit in your income when you receive it if you plan to return it to your tenant at the end of the lease. But if you keep part or all of the security deposit during any year because your tenant does not live up to the terms of the lease, include the amount you keep in your income in that year.

If an amount called a security deposit is to be used as a final payment of rent, it is advance rent. Include it in your income when you receive it.

Other Sources of Rental Income

Lease with option to buy. If the rental agreement gives your tenant the right to buy your rental property, the payments you receive under the agreement are generally rental income. If your tenant exercises the right to buy the property, the payments you receive for the period after the date of sale are considered part of the selling price.

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

Rental of property also used as your 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. Also, expenses from this activity are not considered rental expenses.

II. RENTAL EXPENSES

In most cases, the expenses of renting your property, such as maintenance, insurance, taxes, and interest, can be deducted from your rental income.

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. Also, your rental expense deductions may be limited. See Personal Use of Dwelling Unit (Including Vacation Home).

Part interest. If you own a part interest in rental property, you can deduct expenses you paid according to your percentage of ownership.

Example

Roger owns a one-half undivided interest in a rental house. Last year he paid $968 for necessary repairs on the property. Roger can deduct $484 (50% × $968) as a rental expense. He is entitled to reimbursement for the remaining half from the co-owner.

WHEN TO DEDUCT

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

TYPES OF EXPENSES

Listed below are the most common rental expenses.

- Advertising.
- Auto and travel expenses.
- Cleaning and maintenance.
- Commissions.
- Depreciation.
- Insurance.
- Interest (other).
- Legal and other professional fees.
- Local transportation expenses.
- Management fees.
- Mortgage interest paid to banks, etc.
- Points.
- Rental payments.
- Repairs.
- Taxes.
- Utilities.

Some of these expenses, as well as other less common ones, are discussed next.