PacificCPE

COURSE

34301B

Landlords: Tax Deduction Foundations and Classifications

Before exploring specific deductions, tax professionals need a clear understanding of how rental property taxation works at its core. This course lays the groundwork by covering the fundamental principles of tax deductions for landlords and walking through how landlords are classified for tax purposes. Those classifications drive critical decisions — from which deductions are available to how losses are handled. A solid foundation here sharpens every conversation you have with rental property clients and sets the stage for more confident, accurate tax guidance.

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

Start Course ↓

Final Exam Copy ↓

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 which taxes a landlord may be required to pay.
- Identify the various types of business entities used by landlords.
- Identify what is required for a landlord to qualify as a business.

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: July 2026

TABLE OF CONTENTS

CHAPTER 01

Tax Deduction Basics For Landlords 4

1.01 How Landlords Are Taxed 4

1.02 What Is Rental Income? 7

1.03 How Income Tax Deductions Work 9

1.04 How Property Ownership Affects Taxes 12

Test Your Knowledge 22

CHAPTER 02

Landlord Tax Classifications 26

2.01 The Landlord Tax Categories 26

2.02 Business Owner Vs. Investor 27

2.03 Are You Profit Motivated? 34

Test Your Knowledge 41

Final Exam Copy 46

Glossary 44

Index .....

Chapter 1: TAX DEDUCTION BASICS FOR LANDLORDS

Chapter Objective

After completing this chapter, you should be able to:

- Recognize which taxes a landlord may be required to pay.
- Identify the various types of business entities used by landlords.

The tax code is full of deductions for landlords. Before you can start taking advantage of these deductions, however, you need a basic understanding of how landlords pay taxes and how tax deductions work. This chapter gives you all the information you need to get started, including:

- How the IRS taxes landlords
- How tax deductions work, and
- How forms of property ownership affect landlord taxes.

HOW LANDLORDS ARE TAXED

When you own residential rental property, you're required to pay the following taxes:

- Income taxes on rental income and property sales
- Social Security and Medicare taxes (for some landlords)
- Net investment income tax (for some landlords), and
- Property taxes.

Let's look at each type of tax.

Income Taxes on Rental Income

You must pay federal income taxes on the net income (rent and other money minus expenses) you receive from your rental property each year. When you file your yearly tax return, you add your net rental income to your other income for the year, such as salary income from a job, interest on savings, and investment income. The seven different tax rates (called "tax brackets") range from 10% of taxable income to 37%. (See the chart below.)

2026 Federal Personal Income Tax Rates

Rate	Married Filing Jointly	Individual Return
10%	$0 to $24,800	$0 to $12,240
12%	$24,801 to $100,800	$12,241 to $50,400
22%	$100,801 to $211,400	$50,401 to $105,700
24%	$211,401 to $403,550	$105,701 to $201,775
32%	$403,551 to $512,450	$201,776 to $256,225
35%	$512,451 to $768,700	$256,226 to $640,660
37%	Over $768,700	Over $640,660

This course covers rental property deductions for federal income taxes. However, 41 states also have income taxes. State income tax laws generally track federal tax law, subject to some exceptions. The states without income taxes are Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming. The state of Washington taxes some capital gains over $250,000 (but real estate sales are exempt). For details on your state's income tax law, visit your state tax agency's website, or contact your local state tax office. You can find links to all 50 state tax agency websites at the Federation of Tax Administrators website, at www.taxadmin.org.

Income Taxes When You Sell Your Property

When you sell your property, any profit you earn is added to your income for the year and is subject to taxation. Profits from the sale of rental property owned for more than one year are taxed at capital gains rates. These rates are lower than income tax rates, except for taxpayers in the lowest tax brackets. (See Chapter 1 of course 34304C for an example of the tax effects of a rental property sale.)

But you might be able to defer tax on your profits—perhaps indefinitely—by selling your property through a like-kind exchange (also called a "Section 1031 exchange" or "tax-free exchange"). This kind of exchange involves swapping your property for similar property owned by someone else. These property swaps are subject to complex tax rules that are beyond the scope of this course because they have nothing to do with income tax deductions. For more information, see IRS Publication 544, *Sales and Other Dispositions of Assets*.

Social Security and Medicare Taxes

Everyone who works as an employee or who owns a business must pay Social Security and Medicare payroll taxes (known as "FICA," or "Federal Insurance Contributions Act," taxes). Employees pay half of these taxes themselves and their employers pay the other half. Self-employed people must pay them all themselves. These are two separate taxes.

Social Security tax. The Social Security tax is a flat 12.4% tax on net self-employment income or employee wages up to an annual ceiling, which is adjusted for inflation each year. In 2026, the ceiling was $184,500.

Medicare payroll tax. The two Medicare tax rates are: a 2.9% tax up to an annual ceiling—$200,000 for single taxpayers and $250,000 for married couples filing jointly. All income above the ceiling is taxed at a 3.8% rate.

For both the self-employed and employees, the combined Social Security and Medicare tax is 15.3%, up to the Social Security tax ceiling.

You might have to pay (and withhold) Social Security and Medicare taxes if you hire employees to work in your rental activity—for example, if you hire a resident manager. The employer's share of such taxes is a deductible expense. (See Chapter 3 of course 34306C.)

The income you earn from your rental property isn't subject to Social Security and Medicare taxes even if your rental activities constitute a business for tax purposes. (I.R.C. § 1402(a)(1).) (See Chapter 2.) This is one of the great tax benefits of owning rental property. A person who owns a hot dog stand must pay the 15.3% self-employment tax on their annual profits, whereas a person who owns a rental house or other real estate pays no self-employment taxes on their rental income.

An important exception to the rule that landlords don't have to pay Social Security or Medicare taxes on their rental income is that landlords who provide "substantial services" to their tenants must pay this tax. "Substantial services" are services provided for tenants' convenience that hotels or bed-and-breakfasts typically provide, such as maid service, food, or concierge services. The services' value must be equal to at least 10% or 15% of the rent charged to be substantial. If you provide substantial services to your tenants, your activity is classified as a regular business, not a rental activity. If you're an individual owner, you report your income or losses on IRS Schedule C, *Profit or Loss From Business (Sole Proprietorship)*. Traditional landlords who rent to long-term tenants rarely provide substantial services.

Net Investment Income Tax

The net investment income tax went into effect in 2013. This 3.8% tax affects many higher-income landlords. (For details, see Chapter 4 of course 34308C.)

Property Taxes

Property owners in all states pay property taxes that cities, counties, and other local governments impose. These taxes are based on your rental property's value. Property taxes aren't covered in this course.

WHAT IS RENTAL INCOME?

You only pay tax on your net rental income each year—your total income minus your deductible expenses. Your rental income consists primarily of the rent your tenants pay you for the use of your property. However, rental income can include other types of payments as well. As a rule, neither tenants nor anyone else reports the rent and other payments landlords receive to the IRS.

Estimated Taxes for Landlords

If your rentals earn a profit and you expect to owe at least $1,000 in income tax on the profit, you might need to pay estimated taxes to the IRS to prepay your tax liability. However, if you work and have income tax withheld from your pay, you'll need to pay estimated tax only if your total withholding (and any tax credits) amounts to less than 90% of the total tax you expect to pay for the year. So, you can avoid paying any estimated tax at all by having your withholding increased. But you'll be able to hold on to your money a bit longer if you pay estimated tax instead of having the money taken out of your paychecks every pay period.

If you pay estimated tax, the payments are due four times per year: April 15, June 15, September 15, and January 15. To avoid having to pay an underpayment penalty, your total withholding and estimated tax payments must equal the lesser of either (1) 90% of your tax liability for the current year, or (2) 100% of what you paid the previous year (or 110% if you're a high-income taxpayer— those with adjusted gross incomes of more than $150,000, or $75,000 for married couples filing separate returns).

The easiest way to calculate your quarterly estimated tax payments is to subtract your total expected income tax withholding for the current year from the total income tax you paid last year. The balance is the total amount of estimated tax you must pay this year. But, if you're a high-income taxpayer, add 10% to the total. Note, however, that if your income is higher this year than last, you'll owe extra tax to the IRS on April 15. To account for this increase, you can increase your estimated tax payments or simply save the money you'll need to pay the taxes when you file your annual return.

You pay the money directly to the IRS in four equal installments, so divide the total by four. You can pay by mail, by electronic withdrawal from your bank account, or by credit or debit card. For details, see the IRS estimated tax webpage at www.irs.gov/Businesses/Small-Businesses-Self-Employed/ Estimated-Taxes.

Other Rental Income

Tenants typically make various kinds of payments to their landlords in addition to rent, or provide things of value other than money. Many of these payments must be included in landlord income.

Security deposits. When you receive a security deposit that you plan to use for the tenant's final rent payment, you should include that amount in your income for the year when you receive it. However, don't include security deposit money in your income when you receive it if you plan to return the money to your tenant at the end of the rental term. If you keep part or all of the security deposit at any time because your tenant doesn't live up to the terms of the rental agreement, include the amount you keep in your income for that year.

Interest earned on security deposits is also rental income that should be included in your income in the year it is earned, unless your state or local law requires landlords to credit that interest to tenants.

Property or services in lieu of rent. Property or services you receive from a tenant as rent (instead of money) must be included in your rental income. For example, if your tenant is a painter and offers to paint your rental property instead of paying rent for two months, you must include in your rental income the amount the tenant would have paid for two months' worth of rent.

Rental expenses paid for by tenant. Any rental expenses a tenant paid are rental income, including payments a tenant makes to you for repairs, utilities, or other rental costs. These costs are then deductible by you as rental expenses.

Lease cancellation payments. If a tenant pays you to agree to cancel a lease, the amount you receive is rent that must be included in your rental income in the year you receive it.

Leases with option to buy. A lease with an option to buy occurs if the rental agreement gives your tenant the right to buy your rental property. The payments you receive under such an agreement are generally rental income.

Advance rent payments. 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. For example, to get you to agree to a one-year lease, a tenant with poor credit pays you six months' rent in advance in December. You must include the entire amount as rental income in the year it was received.

Fees. Fees or other charges tenants pay are also rental income. These fees include:

- Fees you charge tenants for paying rent late
- Garage or other parking fees
- Fees you charge tenants for use of storage facilities, and

• Laundry income from washers and dryers you provide for tenants' use.

HOW INCOME TAX DEDUCTIONS WORK

The tax law recognizes that you must spend money on your rental properties for such things as mortgage interest, repairs, maintenance, and many other expenses. The law allows you to subtract these expenses, plus an amount for the depreciation of your property, from your effective gross rental income (all the money actually earned from the property) to determine your taxable income. You pay income tax only on your taxable income, if any. Expenses you can deduct from your income are called "tax deductions" or "tax write-offs." These deductions are what this course is about.

Although some tax deduction calculations can get a bit complicated, the basic math is simple. The entire tax regimen for rental real estate can be reduced to the following simple equation:

Effective gross rental income

minus Operating expenses (including mortgage interest)

minus Depreciation and amortization expenses

= Taxable income

(People who analyze real estate investments don't include mortgage interest as a real estate operating expense, but it is an operating expense for tax purposes.)

Example

Karla owns a rental house. This year, her effective gross rental income (all the income she actually earned from the property) was $10,000. She doesn't pay tax on the entire $10,000 because she had the following expenses—$5,000 in mortgage interest, $1,000 for other operating expenses, and $2,000 for depreciation. She gets to deduct these as outlined in the above equation:

Effective gross rental income	$10,000
Operating expenses	- 6,000
Depreciation and amortization	- 2,000
Taxable income	= $ 2,000

Karla only pays income tax on her $2,000 taxable income.

Many landlords have so many deductions that they end up with a net loss when they subtract all their deductions from their effective gross rental income. In that situation, they owe no tax at all on their rental income. This situation is especially common in the early years of owning rental

property when you haven't had time to raise the rents much. Indeed, it is common for landlords to have a loss for tax purposes even if they take in more in rental income than they pay in expenses each month.

Having a tax loss on your rental property isn't necessarily a bad thing. You might be able to deduct it from other income you earn during the year, such as salary income from a job or income from other investments. However, significant restrictions limit a landlord's ability to deduct rental losses from nonrental income. Many small landlords can avoid them, but not all. These restrictions—known as the "passive loss rules" and "at-risk rules"—are covered in detail in Chapter 1 of course 34308C.

Tax Credits for Landlords

Tax credits aren't the same as tax deductions—they're even better. A "tax credit" is subtracted from your tax liability after you calculate your taxes. For example, a $1,000 tax credit will reduce your taxes for the year by $1,000. Many different types of federal income tax credits exist, but the only credit widely available to owners of residential rentals is the low-income housing credit.

Congress enacted the low-income housing tax credit (LIHTC) to encourage new construction and rehabilitation of existing rental housing for low-income households. The IRS and state tax credit allocation agencies jointly administer the LIHTC, which is used mostly by large real estate developers to build new low-income housing projects. The One Big Beautiful Bill Act enhanced the LIHTC by making a 12% increase in the annual 9% LIHTC allocations permanent starting in 2026, which could result in an additional 80,000 low-income housing units being built over the next decade. For more information, contact your state tax credit allocation agency. You can find a list at www.novoco.com/ resource-centers/affordable-housing-tax-credits/state-lihtc-allocating-agencies. Useful information can also be obtained from the National Housing & Rehabilitation Association website at www. housingonline.com.

No federal income tax credits are available for the cost of eliminating lead paint, asbestos, or mold contamination. However, your state might offer tax credits or other tax incentives for such environmental remediation.

What Can You Deduct?

All tax deductions are a matter of legislative grace, which means that you can take a deduction only if it is specifically allowed by one or more provisions of the tax law. You usually don't have to indicate on your tax return which tax law provision gives you the right to take a particular deduction. If you're audited by the IRS, though, you'll have to provide a legal basis for every deduction you take. If the IRS concludes that your deduction wasn't justified, it will deny the deduction and charge you back taxes and penalties.

Landlords can deduct the following broad categories of rental expenses: