PacificCPE

COURSE
34308B

Landlords: Record keeping, Schedule E, and Net Investment Income Tax

Good tax planning only delivers results when it's backed by accurate records and proper reporting. This course brings everything together by covering recordkeeping and accounting best practices in a rental property context, providing a thorough walkthrough of Schedule E and how rental income and expenses are reported, and examining when the net investment income tax applies to landlords. Tax professionals will walk away with the practical tools to keep rental clients compliant, well-documented, and ready to withstand IRS scrutiny.

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

- Recall recordkeeping requirements for landlords.
- Recognize items included on Schedule E for landlords.
- Recall how the net investment income tax is calculated.

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INTRODUCTION

This course is about income tax deductions for landlords—that is, people who own residential rental property. If you're one of the millions of Americans who own a small number of residential rental units (1 to 10), this course is for you. And even landlords who own dozens of residential rental properties will find lots of useful information in this course that can help them save money.

As you probably know, being a landlord isn't easy. But one thing you have going for you is tax law. Few profit-making activities provide more tax benefits than owning rental property.

No landlord would pay more than necessary for utilities or other operating expenses for a rental property. However, every year, millions of landlords pay more taxes on their rental income than they have to. Why? Because they fail to take advantage of all the tax deductions available to owners of residential rental property. That's where this course comes in. It gives you all the information you need to maximize your deductions—and avoid common deduction mistakes. You can (and should) use this course all year long to make April 15 as painless as possible.

When it comes to understanding your taxes, you need guidance more than ever. In 2017, Congress enacted the most sweeping changes to the tax code in more than 30 years when it passed the Tax Cuts and Jobs Act (TCJA). In 2025, Congress passed the One Big Beautiful Bill Act, which made most of the TCJA's provisions permanent and added some tax law changes of its own. Landlords are among the biggest winners under the Act, which:

- Reinstated 100% bonus depreciation and made it permanent, enabling landlords to supercharge their first-year depreciation deductions for rental properties through cost segregation
- Made the 20% deduction for pass-through business owners, which includes most landlords, permanent
- Made the TCJA's tax rates permanent, with a top rate of 37%
- Established a $40,000 annual deduction for state and local taxes through 2029, and
- Increased the Section 179 limit to $2.5 million (adjusted for inflation).

On the downside, this new law:

- Ends tax credits for solar and other clean energy installations much sooner than scheduled, and makes them more difficult to get, and
- Makes annual limits on deducting business losses permanent.

This course explains how all these changes impact landlords.

This course is written for traditional landlords who rent out their property full time to long-term tenants.

Chapter 1: RECORDKEEPING AND ACCOUNTING

Chapter Objective

After completing this chapter, you should be able to:

- Recall recordkeeping requirements for landlords.

Your deductions for your rental activities are only as good as the records you keep to back them up. Any deduction you forget to claim on your tax return, or lose after an IRS audit because you lack adequate records, costs you dearly. Every $100 in unclaimed deductions costs the average midlevel-income landlord (in a 24% tax bracket) $24 in additional federal income taxes. This chapter shows you how to document your expenditures and other deductions so you won't end up paying more tax than you have to.

WHAT RECORDS DO YOU NEED?

If, like most small landlords, you haven't formed a separate business entity to own your property and have no employees, you need just two types of records for tax purposes:

- A record of your rental income and expenses, and
- Supporting documents for your income and expenses.

You need records of your income and expenses to figure out whether your rental activity earned a taxable profit or incurred a deductible loss during the year. You'll also have to summarize your rental income and expenses for each rental property in your tax return (IRS Schedule E).

You need receipts and other supporting documents, such as credit card records and canceled checks, to serve as insurance in case you're audited by the IRS. These supporting documents enable you to prove to the IRS that your claimed expenses are genuine. Some expenses—travel, for example—require particularly stringent documentation. Without this paper trail, you'll lose valuable deductions in the event of an audit. Remember, if you're audited, it's up to you to prove that your deductions are legitimate.

If you own more than one rental property, you must separately keep track of your income and expenses for each property—don't mix them together. One reason for this inconvenient rule is that the IRS requires that you separately list your income and expenses for each property on your Schedule E. Also, you'll never know how much money you're making or losing on each property unless you separately track your income and expenses.

Paper vs. Electronic Records

The first choice you need to make is whether to keep paper records you create by hand or to use electronic record keeping. Either method is acceptable to the IRS.

Although it might seem old-school, some small landlord owners keep their records by hand on paper, especially when they are first starting out. You can use a columnar pad, notebook paper, or blank ledger books. Also, "one-write systems" allow you to write checks and keep track of expenses simultaneously.

Manual bookkeeping might take a bit more time than using a computer, but it has the advantage of simplicity. You'll always be better off using handwritten ledger sheets, which are easy to create and understand and simple to keep up to date, instead of a complicated software program that you don't understand or use properly.

If you want to use electronic record keeping, many options are available to choose from. These options range from simple personal finance programs to sophisticated property management software. We won't discuss how to use these programs in detail. You'll need to read the manual or tutorial that comes with the program you choose. However, if you're not prepared to invest the time to use a computer program correctly, don't use it.

Create Your Own Spreadsheet

You can create your own spreadsheet to keep track of your expenses and income with software such as Microsoft Excel. Use one spreadsheet per rental and then total them all at the end of the year. See the discussion on how to track business expenses to see what you should include in your spreadsheet.

Software

You can use different software options to help you track your finances. Before getting one, make sure you understand what it offers and how you would use it. You don't want to get something too advanced if a simpler program will do because the more advanced programs can be harder to use and understand. Try to find the one that best suits your needs.

Personal Finance Software

A personal finance program, such as Quicken, might be perfectly adequate for a landlord with just a few units. You create a list of expense categories just like you do when you create a ledger sheet or spreadsheet. Programs like Quicken come with preselected categories, but these aren't adequate for landlords, so you'll probably have to create your own. The software allows you to see all your accounts in one place, automatically categorizes expenses, and has a bill-specific dashboard that lets you save bills or download them as PDFs so the software can categorize and track bill payments.

The program can then take this information and automatically create income and expense reports—that is, it will show you the amounts you've spent or earned for each category, serving the same purpose as the expense journal. It can also create profit and loss statements.

Small Business Accounting Software

Small business accounting programs, such as QuickBooks by Intuit, can do everything personal financial software can do and much more, including create bills, reconcile bank accounts, generate sophisticated reports, create budgets, track employee time, calculate payroll withholding, and generate and maintain fixed asset records.

These programs are more expensive than personal finance software and are harder to learn to use. If you don't need their advanced features, there is no reason to use one of them. A list and comparison of most available accounting software packages and online subscription services can be found at http:// en. wikipedia. org/wiki/Comparison_of_accounting_software.

Property Management Software

Many software applications are designed specifically for rental property management, including Quicken *Home & Business*, Buildium, *Yardi*, *DoorLoop*, and *TurboTenant*. These applications can be particularly helpful if you own more than 10 units. In addition, Apartments.com has a free online landlord expense tracking app. These applications have features designed specifically with landlords in mind. For example, they can:

- Identify tax-deductible rental property expenses
- Track income and expenses by property
- Create a Schedule E report to save you time on taxes
- Show which rents have been paid
- Show how rental properties are doing, and
- Store lease terms, rental rates, and security deposits for each tenant.

If you're interested, you should visit the websites for these applications, try a demo, and see if you need and like their advanced features.

Special Concerns When You Hire Employees

If you have employees—such as a resident manager—you must create and keep a number of records, including payroll tax records, withholding records, and employment tax returns. And you must keep these records for four years.

For detailed information, see IRS Publication 15, Circular E, *Employer's Tax Guide*.You can download it from the IRS website at www.irs.gov. Also, contact your state tax agency for your state's requirements. A list of all 50 state tax agency websites can be found at the Federation of Tax Administrators website, at www.taxadmin.org.

Separate Checkbook and Credit Cards

One of the first things you should do (if you haven't done it already) is set up a separate checking account for your rental activity. Your rental checkbook will serve as your basic source of information for recording your rental expenses and income. Deposit all of your rental income into the account and make rental-related payments by check or debit card from the account. Don't use your rental account to pay for personal expenses or your personal account to pay for rental activity items.

Using a separate account will provide these important benefits:

- It will be much easier for you to keep track of your rental income and expenses if you pay them from a separate account.
- Your rental account will clearly separate your personal and rental activity finances; this will prove very helpful if the IRS audits you.
- Your rental account will help convince the IRS that your rental is a for-profit activity. People with not-for-profit activities don't generally have separate bank accounts to fund their pursuits. (See Chapter 1 of course 34302C for more on establishing your tax status.)

Caution!

Some states require landlords to use a separate account for tenants' security deposits. If your state requires a separate account, you might need to establish two accounts for your business—one for general rental activity, and one for security deposits.

Use a Separate Credit Card for Rental Activity Expenses

Use a separate credit card for rental activity expenses instead of putting both personal and rental items on one card. Credit card interest for rental activity purchases is 100% deductible, while interest for personal purchases isn't deductible at all (see Chapter 1 of course 34305C). Using a

separate card for rental-related purchases will make it much easier for you to keep track of how much interest you've paid for such purchases. If you have more than one personal credit card, you can use one for your rental activity only—you don't need to get a special business credit card.

Dealing With Receipts, Canceled Checks, and Other Supporting Documents

The IRS lives by the maxim "Figures lie and liars figure." It knows very well that you can claim anything in your books and on your tax returns, because you create or complete them yourself. For this reason, the IRS requires that you have documents to support the deductions you claim on your tax return. In the absence of a supporting document, an IRS auditor may conclude that an item you claim as a rental activity expense is really a personal expense, or that you never bought the item at all. Either way, your deduction will be disallowed or reduced.

The supporting documents you need depend on the type of deduction. However, at a minimum, every deduction should be supported by documentation showing:

- What you purchased for your rental activity
- How much you paid for it, and
- Whom (or what company) you bought it from.

You must meet additional record-keeping requirements for local transportation, travel, meal, and gift deductions, as well as for certain long-term assets that you buy for your rental activity. (These rules are covered below.)

You can meet the basic requirements by keeping the following types of documentation:

- Canceled checks
- Sales receipts
- Account statements
- Credit card sales slips
- Invoices, and
- Petty cash slips for small cash payments (these are preprinted receipts that say you paid in cash; you can get them at any stationery store).

Canceled Check + Receipt = Proof of Deduction

We're about to disabuse you of a commonly held belief—that a canceled check will prove that you purchased the item it paid for, especially if you note on the check (or on your register) what the check was for. For example, suppose Manny owns three rental houses. He buys a $500 snowblower to use at his rental properties from the local home supply store. He writes a check for the amount and gets a receipt. How does he prove to the IRS that he has a $500 rental expense?