

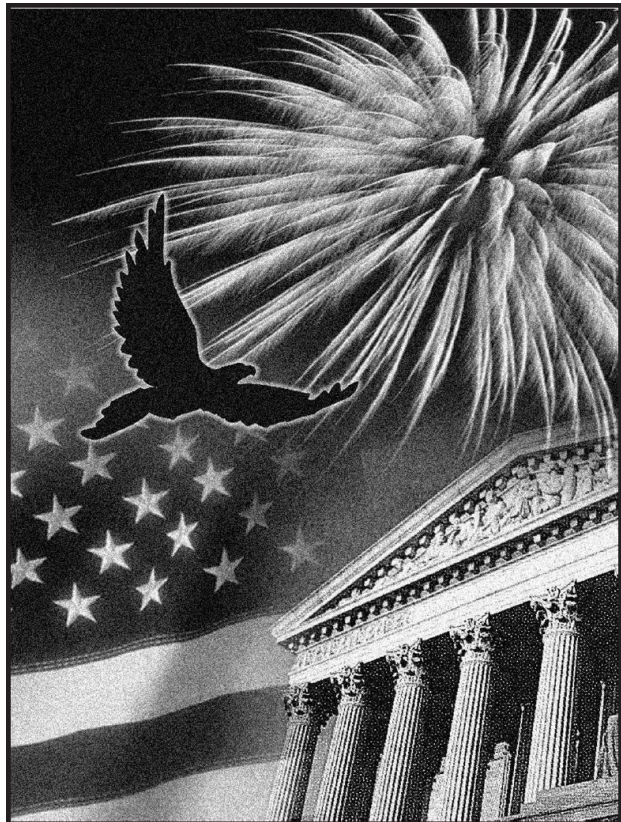
Publication 527

Residential Rental Property (Including Rental of Vacation Homes)

For use in preparing

2025 Returns

Volume 1 of 3



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Future Developments

For the latest information about developments related to Pub. 527, such as legislation enacted after it was published, go to [IRS.gov/Pub527](https://www.irs.gov/pub527).

What's New

Standard mileage rate. For 2025, the standard mileage rate for the cost of

operating your car, van, pickup, or panel truck increased to 70 cents a mile.

Bonus depreciation. The 100% special depreciation allowance is restored for qualified property acquired and placed into service after January 19, 2025. However, property put into service between January 1, 2025, and January 19, 2025, or acquired before January 20, 2025, and put into service later will remain subject to the phase-down rules under prior law. For more information, see Form 4562, Depreciation and Amortization and its instructions.

Increased section 179 deduction dollar limits. For tax years beginning in 2025, the maximum section 179 expense deduction is \$2,500,000. This limit is reduced by the amount by which the cost of section 179 property placed in service during the year exceeds \$4,000,000.

Business interest expense limitation. The business interest expense in your rental real estate activity may be limited. For tax years beginning in 2025, the calculation of adjusted taxable income includes a requirement to add back to taxable income the deductions for depreciation, amortization, and depletion to arrive at the amount that is used to determine if your interest expense is limited. For more information, see Form 8990, Limitation on Business Interest Expense Under Section 163(j), and its instructions.

No tax on car loan interest. If you are self-employed and use your vehicle for personal and business use, you may be eligible to take a deduction for the interest for the personal use on Schedule 1-A (Form 1040). You can only deduct the part of the interest expense that represents the business use of your vehicle on Schedule E (Form 1040). See the Instructions for Schedule 1-A (Form 1040) for more information.

State and local tax (SALT) deduction limit increased. The overall limit on the deduction for state and local income, sales, and property taxes has increased to \$40,000 (\$20,000 if married filing separately). The overall limit is reduced if your modified adjusted gross income is more than \$500,000 (\$250,000 if married filing separately) but will not be reduced below \$10,000 (\$5,000 if married filing separately). See Worksheet 5-1, later.

Reminders

Net Investment Income Tax (NIIT). You may be subject to the NIIT. NIIT is a 3.8% tax on the lesser of net investment income or the excess of modified adjusted gross income (MAGI) over the threshold amount. Net investment income may include rental income and other income from passive activities. Use Form 8960 to figure this tax. For more information on NIIT, go to [IRS.gov/NIIT](https://www.irs.gov/NIIT).

Form 7205, Energy Efficient Commercial

Buildings Deduction. This form and its separate instructions are used to claim the section 179D deduction for qualifying energy efficient commercial building expense(s).

Excess business loss limitation. If you report a loss on line 26, 32, 37, or 39 of your Schedule E (Form 1040), you may be subject to a business loss limitation. The disallowed loss resulting from the limitation will not be reflected on line 26, 32, 37, or 39 of your Schedule E. Instead, use Form 461 to determine the amount of your excess business loss, which will be included as income on Schedule 1 (Form 1040), line 8p. Any disallowed loss resulting from this limitation will be treated as a net operating loss that must be carried forward and deducted in a subsequent year.

See Form 461 and its instructions for details on the excess business loss limitation.

Photographs of missing children. The Internal Revenue Service is a proud partner with the [National Center for Missing & Exploited Children® \(NCMEC\)](#). Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

Do you own a second house that you rent out all the time? Do you own a vacation home that you rent out when you or your family isn't using it?

These are two common types of residential rental activities discussed in this publication. In most cases, all rental income must be reported on your tax return,

but there are differences in the expenses you are allowed to deduct and in the way the rental activity is reported on your return.

Chapter 1 discusses rental-for-profit activity in which there is no personal use of the property. It examines some common types of rental income and when each is reported, as well as some common types of expenses and which are deductible.

Chapter 2 discusses depreciation as it applies to your rental real estate activity—what property can be depreciated and how much it can be depreciated.

Chapter 3 covers the reporting of your rental income and deductions, including casualties and thefts, limitations on losses, and claiming the correct amount of depreciation.

Chapter 4 discusses special rental situations.

These include condominiums, cooperatives, property changed to rental use, renting only part of your property, and a not-for-profit rental activity.

Chapter 5 discusses the rules for rental income and expenses when there is also personal use of the dwelling unit, such as a vacation home.

Finally, chapter 6 explains how to get tax help from the IRS.

Sale or exchange of rental property. For information on how to figure and report any gain or loss from the sale, exchange, or other disposition of your rental property, see Pub. 544.

Sale of main home used as rental property. For information on how to figure and report any gain or loss from the sale or other disposition of your main home that you also used as rental property, see Pub. 523.

Tax-free exchange of rental property occasionally used for personal purposes.

If you meet certain qualifying use standards, you may qualify for a tax-free exchange (a like-kind or section 1031 exchange) of one piece of rental property you own for a similar piece of rental property, even if you have used the rental property for personal purposes.

For information on the qualifying use standards, see Revenue Procedure 2008-16, 2008-10 I.R.B. 547, available at [IRS.gov/irb/2008-10_IRB#RP-2008-16](https://www.irs.gov/irb/2008-10_IRB#RP-2008-16). For more information on like-kind exchanges, see chapter 1 of Pub. 544.

Comments and suggestions. We welcome your comments about this publication and suggestions for future editions.

You can send us comments through [IRS.gov/FormComments](https://www.irs.gov/FormComments). Or, you can write to the Internal Revenue Service,

Tax Forms and Publications, 1111
Constitution Ave. NW, IR-6526,
Washington, DC 20224.

Although we can't respond individually to each comment received, we do appreciate your feedback and will consider your comments and suggestions as we revise our tax forms, instructions, and publications.

Don't send tax questions, tax returns, or payments to the above address.

Getting answers to your tax questions. If you have a tax question not answered by this publication or the *How To Get Tax Help* section at the end of this publication, go to the IRS Interactive Tax Assistant page at [IRS.gov/ Help/ITA](https://www.irs.gov/help/ita) where you can find topics by using the search feature or viewing the categories listed.

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Useful Items

You may want to see:

Publication

- ☐ **463** Travel, Gift, and Car Expenses
- ☐ **523** Selling Your Home
- ☐ **534** Depreciating Property Placed in Service Before 1987
- ☐ **544** Sales and Other Dispositions of Assets
- ☐ **547** Casualties, Disasters, and Thefts

- **551** Basis of Assets
- **925** Passive Activity and At-Risk Rules
- **946** How To Depreciate Property

Form (and Instructions)

- **461** Excess Business Loss Limitation
- **4562** Depreciation and Amortization
- **5213** Election To Postpone
Determination as To Whether the
Presumption Applies That an Activity Is
Engaged in for Profit
- **7205** Energy Efficient Commercial
Buildings Deduction
- **8582** Passive Activity Loss Limitations
- **8960** Net Investment Income Tax—
Individuals, Estates, and Trusts
- **Schedule E (Form 1040)**
Supplemental Income and Loss

1.

Rental Income and Expenses (If No Personal Use of Dwelling)

This chapter discusses the various types of rental income and expenses for a residential rental activity with no personal use of the dwelling. Generally, each year, you will report all income and deduct all out-of-pocket expenses in full. The deduction to recover the cost of your rental property—depreciation—is taken over a prescribed number of years, and is discussed in chapter 2.



If your rental income is from property you also use personally or rent to someone at less than a fair rental price, first read chapter 5.

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 isn't 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 or an accrual basis taxpayer. 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.

More information. See Pub. 538, Accounting Periods and Methods, for more information about when you constructively receive income and accrual methods of accounting.

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 rental income in the year you receive it regardless of your method of accounting.

Expenses paid by tenant. If your tenant pays any of your 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 doesn't 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 (FMV) 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 FMV 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. Don't 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 doesn't 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, you must report your part 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 less than 15 days during the tax year, don't include the rent you receive in your income. Also, expenses from this activity are not considered rental expenses.

For more information, see *Used as a home but rented less than 15 days* under *Reporting Income and Deductions* in chapter 5.

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 chapter 5.

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\% (0.50) \times \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.

If you use the accrual method, see Pub. 538 for more information.

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 below.

Depreciation. Depreciation is a capital expense. It is the mechanism for recovering your cost in an income-producing property

and must be taken over the expected life of the property.

You can begin to depreciate rental property when it is ready and available for rent. See *Placed in Service* under *When Does Depreciation Begin and End?* in chapter 2.

Insurance premiums paid in advance.

If you pay an insurance premium for more than 1 year in advance, you can't deduct the total premium in the year you pay it. For each year of coverage, you can deduct only the part of the premium payment that applies to that year.

Interest expense. You can deduct mortgage interest you pay on your rental property.

When you refinance a rental property for more than the previous outstanding balance, the portion of the interest allocable to loan proceeds not related to rental use generally can't be deducted as a rental expense.

Expenses paid to obtain a mortgage.

Certain expenses you pay to obtain a mortgage on your rental property can't be deducted as interest. These expenses, which include mortgage commissions, abstract fees, and recording fees, are capital expenses that are part of your basis in the property.

Form 1098, Mortgage Interest

Statement. If you paid \$600 or more of mortgage interest on your rental property to any one person, you should receive a Form 1098 or similar statement showing the interest you paid for the year. If you and at least one other person (other than your spouse if you file a joint return) were liable for, and paid interest on, the mortgage, and the other person received the Form 1098, report your share of the interest on Schedule E (Form 1040), line 13. Attach a statement to your return showing the name and address of the other person. On the dotted line next to line 13, enter "See attached."

Legal and other professional fees. You can deduct, as a rental expense, legal and other professional expenses such as tax return preparation fees you paid to prepare Schedule E, Part I. For example, on your 2025 Schedule E, you can deduct fees paid in 2025 to prepare Part I of your 2024 Schedule E. You can also deduct, as a rental expense, any expense (other than federal taxes and penalties) you paid to resolve a tax underpayment related to your rental activities.

Local benefit taxes. In most cases, you can't deduct charges for local benefits that increase the value of your property, such as charges for putting in streets, sidewalks, or water and sewer systems. These charges are nondepreciable capital expenditures and must be added to the basis of your property. However, you can deduct local benefit taxes that are for maintaining, repairing, or paying interest charges for the benefits.

Local transportation expenses. You may be able to deduct your ordinary and necessary local transportation expenses if you incur them to collect rental income or to manage, conserve, or maintain your rental property. However, transportation expenses incurred to travel between your home and a rental property generally constitute nondeductible commuting costs unless you use your home as your principal place of business. See Pub. 587, *Business Use of Your Home*, for information on determining if your home office qualifies as a principal place of business.

Generally, if you use your personal car, pickup truck, or light van for rental activities, you can deduct the expenses using one of two methods: actual expenses or the standard mileage rate. For 2025, the standard mileage rate is 70 cents a mile. For more information, see chapter 4 of Pub. 463.



To deduct car expenses under either method, you must keep records that follow the rules in chapter 5 of Pub.

463. In addition, you must complete Form 4562, Part V, and attach it to your tax return.



If you use your vehicle for both business and personal purposes and you claimed a deduction in 2025 on Schedule 1-A (Form 1040) for the vehicle loan interest allocable to your personal use, then you can't claim a deduction for that same interest on Schedule E (or Schedule C, if applicable). See Schedule 1-A (Form 1040) and its instructions for more information.

Pre-rental expenses. You can deduct your ordinary and necessary expenses for managing, conserving, or maintaining rental property from the time you make it available for rent.

Rental of equipment. You can deduct the rent you pay for equipment that you use for rental purposes.

However, in some cases, lease contracts are actually purchase contracts. If so, you can't deduct these payments. You can recover the cost of purchased equipment through depreciation.

Rental of property. You can deduct the rent you pay for property that you use for rental purposes. If you buy a leasehold for rental purposes, you can deduct an equal part of the cost each year over the term of the lease.

Travel expenses. You can deduct the ordinary and necessary expenses of traveling away from home if the primary purpose of the trip is to collect rental income or to manage, conserve, or maintain your rental property. You must properly allocate your expenses between rental and nonrental activities. You can't deduct the cost of traveling away from home if the primary purpose of the trip is to improve the property.

The cost of improvements is recovered by taking depreciation. For information on travel expenses, see chapter 1 of Pub. 463.



To deduct travel expenses, you must keep records that follow the rules in chapter 5 of Pub. 463.

Uncollected rent. If you are a cash basis taxpayer, don't deduct uncollected rent. Because you haven't included it in your income, it's not deductible.

If you use an accrual method, report income when you earn it. If you are unable to collect the rent, you may be able to deduct it as a business bad debt. See section 166 and its regulations for more information about business bad debts.

Vacant rental property. If you hold property for rental purposes, you may be able to deduct your ordinary and necessary expenses (including depreciation) for managing, conserving, or maintaining the

property while the property is vacant. However, you can't deduct any loss of rental income for the period the property is vacant.

Vacant while listed for sale. If you sell property you held for rental purposes, you can deduct the ordinary and necessary expenses for managing, conserving, or maintaining the property until it is sold. If the property isn't held out and available for rent while listed for sale, the expenses aren't deductible rental expenses.

Points

The term "points" is often used to describe some of the charges paid, or treated as paid, by a borrower to take out a loan or a mortgage. These charges are also called loan origination fees, maximum loan charges, or premium charges. Any of these charges (points) that are solely for the use of money are interest.

Because points are prepaid interest, you generally can't deduct the full amount in the year paid, but must deduct the interest over the term of the loan.

The method used to figure the amount of points you can deduct each year follows the original issue discount (OID) rules. In this case, points paid (or treated as paid (such as seller paid points)), by a borrower to a lender increase OID which is the excess of:

- Stated redemption price at maturity (generally the stated principal amount of the mortgage loan) over
- Issue price (generally the amount borrowed reduced by the points).

Note: For more detailed information to determine OID on a mortgage loan, including how to determine the stated redemption price at maturity and issue price of a mortgage loan, see the regulations under section 1273.

The first step to determine the amount of your deduction for the points is to determine whether your total OID on the mortgage loan, including the OID resulting from the points, is de minimis. If the OID isn't de minimis, you must use the constant-yield method to figure how much you can deduct.

De minimis OID. The OID is de minimis if it is less than one-fourth of 1% (0.0025) of the stated redemption price at maturity multiplied by the number of full years from the date of original issue to maturity (term of the loan).

If the OID is de minimis, you can choose one of the following ways to figure the amount of points you can deduct each year.

- On a constant-yield basis over the term of the loan.
- On a straight line basis over the term of the loan.
- In proportion to stated interest payments.

- In its entirety at maturity of the loan.

You make this choice by deducting the OID (including the points) in a manner consistent with the method chosen on your timely filed tax return for the tax year in which the loan is issued.

Example. Carol took out a \$100,000 mortgage loan on January 1, 2025, to buy a house she will use as a rental during 2025. The loan is to be repaid over 30 years. The loan requires interest payable each year at a fixed rate. During 2025, Carol paid \$10,000 of mortgage interest (stated interest) to the lender. When the loan was made, she paid \$1,500 in points to the lender. The amount of the OID on the loan is \$1,500, which is the excess of the stated redemption price at maturity of \$100,000 over the issue price of \$98,500 (the amount borrowed of \$100,000 minus the points paid of \$1,500).

Carol determines that the points (OID) she paid are de minimis based on the following computation.

Stated redemption price at maturity (principal amount of the loan in this case).....	\$100,000
Multiplied by: The term of the loan in complete years.....	×30
Multiplied by.....	<u>×0.0025</u>
De minimis amount.....	<u>\$ 7,500</u>

The points (OID) she paid (\$1,500) are less than the de minimis amount (\$7,500).

Therefore, Carol has de minimis OID and she can choose one of the four ways discussed earlier to figure the amount she can deduct each year. Under the straight line method, she can deduct \$50 each year for 30 years.

Constant-yield method. If the OID (including the points) isn't de minimis, you

must use the constant-yield method to figure how much you can deduct each year.

You figure your deduction for the first year in the following manner.

1. Determine the issue price of the loan. If you paid points on the loan, the issue price is generally the difference between the amount borrowed and the points.
2. Multiply the result in (1) by the yield to maturity (defined later).
3. Subtract any qualified stated interest payments (defined later) from the result in (2). This is the OID you can deduct in the first year.

Yield to maturity (YTM). This rate is generally shown in the literature you receive from your lender.

If you don't have this information, consult your lender or tax advisor. In general, the

YTM is the discount rate that, when used in computing the present value of all principal and interest payments, produces an amount equal to the issue price of the loan.

Qualified stated interest (QSI). In general, this is the stated interest that is unconditionally payable in cash or property (other than another debt instrument of the borrower) at least annually over the term of the loan at a fixed rate.

Example—Year 1. The facts are the same as in the previous example. The YTM on Carol's loan is 10.2467%, compounded annually.

She figured the amount of points (OID) she could deduct in 2025 as follows.

Amount borrowed	\$100,000
Minus: Points (OID).....	<u>-1,500</u>
Issue price of the loan.....	\$ 98,500
Multiplied by: YTM.....	<u>× 0.102467</u>

Total.....	10,093
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Minus: QSI.....	<u>-10,000</u>
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Points (OID) deductible in 2025.....	<u>\$ 93</u>
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To figure your deduction in any subsequent year, you start with the adjusted issue price. To get the adjusted issue price, add to the issue price figured in Year 1 any OID previously deducted. Then, follow steps (2) and (3), earlier.

Example—Year 2. Carol figured the deduction for 2026 as follows.

Issue price.....	\$98,500
------------------	----------

Plus: Points (OID) deducted in 2025.....	<u>+93</u>
--	------------

Adjusted issue price.....	\$98,593
---------------------------	----------

Multiplied by: YTM.....	<u>× 0.102467</u>
-------------------------	-------------------

Total.....	10,103
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Minus: QSI..... -10,000

**Points (OID) deductible in
2026..... \$103**

Loan or mortgage ends. If your loan or mortgage ends, you may be able to deduct any remaining points (OID) in the tax year in which the loan or mortgage ends. A loan or mortgage may end due to a refinancing, prepayment, foreclosure, or similar event. However, if the refinancing is with the same lender, the remaining points (OID) generally aren't deductible in the year in which the refinancing occurs, but may be deductible over the term of the new mortgage or loan.

Points when loan refinance is more than the previous outstanding balance. When you refinance a rental property for more than the previous outstanding balance, the portion of the points allocable to loan proceeds **not** related to rental use generally can't be deducted as a rental expense.

Example. You refinanced a loan with a balance of \$100,000. The amount of the new loan was \$120,000. You used the additional \$20,000 to purchase a car. The points allocable to the \$20,000 would be treated as nondeductible personal interest.

Repairs and Improvements

Generally, an expense for repairing or maintaining your rental property may be deducted if you aren't required to capitalize the expense.

Improvements. You must capitalize any expense you pay to improve your rental property. An expense is for an improvement if it results in a betterment to your property, restores your property, or adapts your property to a new or different use. Table 1-1 shows examples of many improvements.

Betterments. Expenses that may result in a betterment to your property include expenses for fixing a pre-existing defect or condition,

enlarging or expanding your property, or increasing the capacity, strength, or quality of your property.

Restoration. Expenses that may be for restoration include expenses for replacing a substantial structural part of your property, repairing damage to your property after you properly adjusted the basis of your property as a result of a casualty loss, or rebuilding your property to a like-new condition.

Adaptation. Expenses that may be for adaptation include expenses for altering your property to a use that isn't consistent with the intended ordinary use of your property when you began renting the property.

De minimis safe harbor for tangible property. If you elect this de minimis safe harbor for your rental activity for the tax year, you aren't required to capitalize the de minimis costs of acquiring or producing certain real and tangible personal property and may deduct these amounts as rental

expenses on line 19 of Schedule E. For more information on electing and using the de minimis safe harbor for tangible property, see [*Tangible Property Regulations-Frequently Asked Questions*](#).

Safe harbor for routine maintenance. If you determine that your cost was for an improvement to a building or equipment, you may still be able to deduct your cost under the routine maintenance safe harbor. See [*Tangible Property Regulations-Frequently Asked Questions*](#) for more information.



Separate the costs of repairs and improvements, and keep accurate records. You will need to know the cost of improvements when you sell or depreciate your property.

The expenses you capitalize for improving your property can generally be depreciated as if the improvement were separate property.

2.

Depreciation of Rental Property

You recover the cost of income-producing property through yearly tax deductions. You do this by depreciating the property; that is, by deducting some of the cost each year on your tax return.

Three factors determine how much depreciation you can deduct each year: (1) your basis in the property, (2) the recovery period for the property, and (3) the depreciation method used. You can't simply deduct your mortgage or principal payments, or the cost of furniture, fixtures, and equipment, as an expense.

You can deduct depreciation only on the part of your property used for rental purposes. Depreciation reduces your basis for figuring gain or loss on a later sale or exchange.

You may have to use Form 4562 to figure and report your depreciation. See *Which Forms To Use* in chapter 3. Also, see Pub. 946.

Section 179 deduction. The section 179 deduction is a means of recovering part or all of the cost of certain qualifying property in the year you place the property in service. It is separate from your depreciation deduction. See chapter 2 of Pub. 946 for more information about claiming this deduction.

Alternative minimum tax (AMT). If you use accelerated depreciation, you may be subject to the AMT. Accelerated depreciation allows you to deduct more depreciation earlier in the recovery period than you could deduct using a straight line method (same deduction each year).

The prescribed depreciation methods for rental real estate aren't accelerated, so the depreciation deduction isn't adjusted for the AMT.

However, accelerated methods are generally used for other property connected with rental activities (for example, appliances and wall-to-wall carpeting).

To find out if you are subject to the AMT, see the Instructions for Form 6251.

The Basics

The following section discusses the information you will need to have about the rental property and the decisions to be made before figuring your depreciation deduction.

What Rental Property Can Be Depreciated?

You can depreciate your property if it meets all the following requirements.

- You own the property.
- You use the property in your business or income-producing activity (such as rental property).

- The property has a determinable useful life.
- The property is expected to last more than 1 year.

Property you own. To claim depreciation, you must usually be the owner of the property. You are considered to be the owner of the property even if it's subject to a debt.

Rented property. Generally, if you pay rent for property, you can't depreciate that property. Usually, only the owner can depreciate it. However, if you make permanent improvements to leased property, you may be able to depreciate the improvements. See *Additions or improvements to property*, later in this chapter, under *Recovery Periods Under GDS*.

Cooperative apartments. If you are a tenant-stockholder in a cooperative housing corporation and rent your cooperative

apartment to others, you can depreciate your stock in the corporation. See chapter 4.

Property having a determinable useful life. To be depreciable, your property must have a determinable useful life. This means that it must be something that wears out, decays, gets used up, becomes obsolete, or loses its value from natural causes.

Table 1-1. **Examples of Improvements**

Additions Bedroom Bathroom Deck Garage Porch Patio	Miscellaneous Storm windows, doors New roof Central vacuum Wiring upgrades Satellite dish Security system	Plumbing Septic system Water heater Soft water system Filtration system
Lawn & Grounds Landscaping Driveway Walkway Fence Retaining wall Sprinkler system Swimming pool	Heating & Air Conditioning Heating system Central air conditioning Furnace Duct work Central humidifier Filtration system	Interior Improvements Built-in appliances Kitchen modernization Flooring Wall-to-wall carpeting
		Insulation Attic Walls, floor Pipes, duct work

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What Rental Property Can't Be Depreciated?

Certain property can't be depreciated. This includes land and certain excepted property.

Land. You can't depreciate the cost of land because land generally doesn't wear out, become obsolete, or get used up. But if it does, the loss is accounted for upon disposition. The costs of clearing, grading, planting, and landscaping are usually all part of the cost of land and can't be depreciated. You may, however, be able to depreciate certain land preparation costs if the costs are so closely associated with other depreciable property that you can determine a life for them along with the life of the associated property.

Example. You built a new house to use as a rental and paid for grading, clearing, seeding, and planting bushes and trees. Some of the bushes and trees were planted right next to the house, while others were planted around

the outer border of the lot. If you replace the house, you would have to destroy the bushes and trees right next to it. These bushes and trees are closely associated with the house, so they have a determinable useful life.

Therefore, you can depreciate them. Add your other land preparation costs to the basis of your land because they have no determinable life and you can't depreciate them.

Excepted property. Even if the property meets all the requirements listed earlier under *What Rental Property Can Be Depreciated*, you can't depreciate the following property.

- Property placed in service and disposed of (or taken out of business use) in the same year.
- Equipment used to build capital improvements. You must add otherwise allowable depreciation on the equipment during the period of construction to the basis of your improvements.

For more information, see chapter 1 of Pub. 946.

When Does Depreciation Begin and End?

You begin to depreciate your rental property when you place it in service for the production of income. You stop depreciating it either when you have fully recovered your cost or other basis, or when you retire it from service, whichever happens first.

Placed in Service

You place property in service in a rental activity when it is ready and available for a specific use in that activity. Even if you aren't using the property, it is in service when it is ready and available for its specific use.

Example 1. On November 22 of last year, you purchased a dishwasher for your rental property. The appliance was delivered on December 7,

but wasn't installed and ready for use until January 3 of this year. Because the dishwasher wasn't ready for use last year, it isn't considered placed in service until this year.

If the appliance had been installed and ready for use when it was delivered in December of last year, it would have been considered placed in service in December, even if it wasn't actually used until this year.

Example 2. On April 6, you purchased a house to use as residential rental property. You made extensive repairs to the house and had it ready for rent on July 5. You began to advertise the house for rent in July and actually rented it beginning September 1. The house is considered placed in service in July when it was ready and available for rent. You can begin to depreciate the house in July.

Example 3. You moved from your home in July. During August and September, you made several repairs to the house.

On October 1, you listed the property for rent with a real estate company, which rented it on December 1. The property is considered placed in service on October 1, the date when it was available for rent.

Conversion to business use. If you place property in service in a personal activity, you can't claim depreciation. However, if you change the property's use to business or the production of income, you can begin to depreciate it at the time of the change. You place the property in service for business or income-producing use on the date of the change.

Example. You bought a house and used it as your personal home several years before you converted it to rental property. Although its specific use was personal and no depreciation was allowable, you placed the home in service when you began using it as your home.

You can begin to claim depreciation in the year you converted it to rental property because at that time its use changed to the production of income.

Idle Property

Continue to claim a deduction for depreciation on property used in your rental activity even if it is temporarily idle (not in use). For example, if you must make repairs after a tenant moves out, you still depreciate the rental property during the time it isn't available for rent.

Cost or Other Basis Fully Recovered

You must stop depreciating property when the total of your yearly depreciation deductions equals your cost or other basis of your property. For this purpose, your yearly depreciation deductions include any depreciation that you were allowed to claim, even if you didn't claim it. See *Basis of Depreciable Property*, later.

Retired From Service

You stop depreciating property when you retire it from service, even if you haven't fully recovered its cost or other basis. You retire property from service when you permanently withdraw it from use in a trade or business or from use in the production of income because of any of the following events.

- You sell or exchange the property.
- You convert the property to personal use.
- You abandon the property.
- The property is destroyed.

Depreciation Methods

Generally, you must use the Modified Accelerated Cost Recovery System (MACRS) to depreciate residential rental property placed in service after 1986.

If you placed rental property in service before 1987, you are using one of the following methods.

- Accelerated Cost Recovery System (ACRS) for property placed in service after 1980 but before 1987.
- Straight line or declining balance method over the useful life of property placed in service before 1981.

See MACRS Depreciation, later, for more information.

Rental property placed in service before 2025. Continue to use the same method of figuring depreciation that you used in the past.

Use of real property changed. Generally, you must use MACRS to depreciate real property that you acquired for personal use before 1987 and changed to business or income-producing use after 1986.

This includes your residence that you changed to rental use. See *Property Owned or Used in 1986* in chapter 1 of Pub. 946 for those situations in which MACRS isn't allowed.

Improvements made after 1986. Treat an improvement made after 1986 to property you placed in service before 1987 as separate depreciable property. As a result, you can depreciate that improvement as separate property under MACRS if it is the type of property that otherwise qualifies for MACRS depreciation. For more information about improvements, see *Additions or improvements to property*, later in this chapter, under *Recovery Periods Under GDS*.



This publication discusses MACRS depreciation only. If you need information about depreciating property placed in service before 1987, see Pub. 534.

Basis of Depreciable Property

The basis of property used in a rental activity is generally its adjusted basis when you place it in service in that activity. This is its cost or other basis when you acquired it, adjusted for certain items occurring before you place it in service in the rental activity.

If you depreciate your property under MACRS, you may also have to reduce your basis by certain deductions and credits with respect to the property.

Basis and adjusted basis are explained in the following discussions.



If you used the property for personal purposes before changing it to rental use, its basis for depreciation is the lesser of its adjusted basis or its FMV when you change it to rental use. See Basis of Property Changed to Rental Use in chapter 4.

Cost Basis

The basis of property you buy is usually its cost. The cost is the amount you pay for it in cash, in debt obligation, in other property, or in services. Your cost also includes amounts you pay for:

- Sales tax charged on the purchase (but see *Exception* next),
- Freight charges to obtain the property, and
- Installation and testing charges.

Exception. If you deducted state and local general sales taxes as an itemized deduction on Schedule A (Form 1040), don't include as part of your cost basis the sales taxes you deducted. Such taxes were deductible before 1987 and after 2003.

Loans with low or no interest. If you buy property on any payment plan that charges little or no interest, the basis of your property

is your stated purchase price, less the amount considered to be unstated interest. See *Unstated Interest and Original Issue Discount (OID)* in Pub. 537, Installment Sales.

Real property. If you buy real property, such as a building and land, certain fees and other expenses you pay are part of your cost basis in the property.

Real estate taxes. If you buy real property and agree to pay real estate taxes on it that were owed by the seller and the seller doesn't reimburse you, the taxes you pay are treated as part of your basis in the property. You can't deduct them as taxes paid.

If you reimburse the seller for real estate taxes the seller paid for you, you can usually deduct that amount. Don't include that amount in your basis in the property.

Settlement fees and other costs. The following settlement fees and closing costs for buying the property are part of your basis in the property.

- Abstract fees.
- Charges for installing utility services.
- Legal fees.
- Recording fees.
- Surveys.
- Transfer taxes.
- Title insurance.
- Any amounts the seller owes that you agree to pay, such as back taxes or interest, recording or mortgage fees, charges for improvements or repairs, and sales commissions.

The following are settlement fees and closing costs you can't include in your basis in the property.

1. Fire insurance premiums.
2. Rent or other charges relating to occupancy of the property before closing.
3. Charges connected with getting or refinancing a loan, such as:
 - a. Points (discount points, loan origination fees),
 - b. Loan assumption fees,
 - c. Cost of a credit report, and
 - d. Fees for an appraisal required by a lender.

Also, don't include amounts placed in escrow for the future payment of items such as taxes and insurance.

Assumption of a mortgage. If you buy property and become liable for an existing mortgage on the property,

your basis is the amount you pay for the property plus the amount remaining to be paid on the mortgage.

Example. You buy a building for \$60,000 cash and assume a mortgage of \$240,000 on it. Your basis is \$300,000.

Separating cost of land and buildings. If you buy buildings and your cost includes the cost of the land on which they stand, you must divide the cost between the land and the buildings to figure the basis for depreciation of the buildings. The part of the cost that you allocate to each asset is the ratio of the FMV of that asset to the FMV of the whole property at the time you buy it.

If you aren't certain of the FMVs of the land and the buildings, you can divide the cost between them based on their assessed values for real estate tax purposes.

Example. You buy a house and land for \$200,000. The purchase contract doesn't specify how much of the purchase price is for the house and how much is for the land.

The latest real estate tax assessment on the property was based on an assessed value of \$160,000, of which \$136,000 was for the house and \$24,000 was for the land.

You can allocate 85% ($\$136,000 \div \$160,000$) of the purchase price to the house and 15% ($\$24,000 \div \$160,000$) of the purchase price to the land.

Your basis in the house is \$170,000 (85% of \$200,000) and your basis in the land is \$30,000 (15% of \$200,000).

Basis Other Than Cost

You can't use cost as a basis for property that you received:

- In return for services you performed;
- In an exchange for other property;

- As a gift;
- From your spouse, or from your former spouse as the result of a divorce; or
- As an inheritance.

If you received property in one of these ways, see Pub. 551 for information on how to figure your basis.

Adjusted Basis

To figure your property's basis for depreciation, you may have to make certain adjustments (increases and decreases) to the basis of the property for events occurring between the time you acquired the property and the time you placed it in service for business or the production of income. The result of these adjustments to the basis is the adjusted basis.

Increases to basis. You must increase the basis of any property by the cost of all items

properly added to a capital account. These include the following.

- The cost of any additions or improvements made before placing your property into service as a rental that have a useful life of more than 1 year.
- Amounts spent after a casualty to restore the damaged property.
- The cost of extending utility service lines to the property.
- Legal fees, such as the cost of defending and perfecting title, or settling zoning issues.

Additions or improvements. Add to the basis of your property the amount an addition or improvement actually costs you, including any amount you borrowed to make the addition or improvement. This includes all direct costs, such as material and labor, but doesn't include your own labor.

It also includes all expenses related to the addition or improvement.

For example, if you had an architect draw up plans for remodeling your property, the architect's fee is a part of the cost of the remodeling. Or, if you had your lot surveyed to put up a fence, the cost of the survey is a part of the cost of the fence.

Keep separate accounts for depreciable additions or improvements made after you place the property in service in your rental activity. For information on depreciating additions or improvements, see Additions or improvements to property, later in this chapter, under *Recovery Periods Under GDS*.



The cost of landscaping improvements is usually treated as an addition to the basis of the land, which isn't depreciable. However, see What Rental Property Can't Be Depreciated, earlier.

Assessments for local improvements.

Assessments for items which tend to increase the value of property, such as streets and sidewalks, must be added to the basis of the property. For example, if your city installs curbing on the street in front of your house, and assesses you and your neighbors for its cost, you must add the assessment to the basis of your property. Also, add the cost of legal fees paid to obtain a decrease in an assessment levied against property to pay for local improvements. You can't deduct these items as taxes or depreciate them.

However, you can deduct assessments for the purpose of maintenance or repairs or for the purpose of meeting interest charges related to the improvements. Don't add them to your basis in the property.

Deducting vs. capitalizing costs. Don't add to your basis costs you can deduct as current expenses. However, there are certain costs you can choose either to deduct or to

capitalize. If you capitalize these costs, include them in your basis. If you deduct them, don't include them in your basis.

The costs you may choose to deduct or capitalize include carrying charges, such as interest and taxes, that you must pay to own property.

For more information about deducting or capitalizing costs and how to make the election, see *Carrying Charges* in sections 263A and 266.

Decreases to basis. You must decrease the basis of your property by any items that represent a return of your cost. These include the following.

- Insurance or other payment you receive as the result of a casualty or theft loss.
- Casualty loss not covered by insurance for which you took a deduction.

- Amount(s) you receive for granting an easement.
- Residential energy credits you were allowed before 1986 or after 2005 if you added the cost of the energy items to the basis of your home.
- Exclusion from income of subsidies for energy conservation measures.
- Special depreciation allowance or a section 179 deduction claimed on qualified property.
- Depreciation you deducted or could have deducted on your tax returns under the method of depreciation you chose. If you didn't deduct enough or deducted too much in any year, see *Depreciation* under *Decreases to Basis* in Pub. 551.

If your rental property was previously used as your main home, you must also decrease the basis by the following.

- Gain you postponed from the sale of your main home before May 7, 1997, if the replacement home was converted to your rental property.
- District of Columbia first-time homebuyer credit allowed on the purchase of your main home after August 4, 1997, and before January 1, 2012. •
- Amount of qualified principal residence indebtedness discharged on or after January 1, 2007.

Special Depreciation Allowance

For 2025, some properties used in connection with residential real property activities may qualify for a special depreciation allowance. This allowance is figured before you figure your regular depreciation deduction. See chapter 3 of Pub. 946 for details. Also, see the instructions for Form 4562, line 14.

If you qualify for, but choose not to take, a special depreciation allowance, you must attach a statement to your return. The details of this election are in chapter 3 of Pub. 946 and the instructions for Form 4562, line 14.

MACRS Depreciation

Most business and investment property placed in service after 1986 is depreciated using MACRS.

This section explains how to determine which MACRS depreciation system applies to your property. It also discusses other information you need to know before you can figure depreciation under MACRS. This information includes the property's:

- Recovery class,
- Applicable recovery period,
- Convention,
- Placed-in-service date,

- Basis for depreciation, and
- Depreciation method.

Depreciation Systems

MACRS consists of two systems that determine how you depreciate your property—the General Depreciation System (GDS) and the Alternative Depreciation System (ADS). You must use GDS unless you are specifically required by law to use ADS or you elect to use ADS.

Excluded Property

You can't use MACRS for certain personal property (such as furniture or appliances) placed in service in your rental property in 2025 if it had been previously placed in service before 1987, when MACRS became effective.

In most cases, personal property is excluded from MACRS if you (or a person related to you) owned or used it in 1986 or if your

tenant is a person (or someone related to the person) who owned or used it in 1986.

However, the property isn't excluded if your 2025 deduction under MACRS (using a half-year convention) is less than the deduction you would have under ACRS. For more information, see *What Method Can You Use To Depreciate Your Property?* in chapter 1 of Pub. 946.

Electing ADS

If you choose, you can use the ADS method for most property. Under ADS, you use the straight line method of depreciation.

The election of ADS for one item in a class of property generally applies to all property in that class placed in service during the tax year of the election. However, the election applies on a property-by-property basis for residential rental property and nonresidential real property.

If you choose to use ADS for your residential rental property, the election must be made in the first year the property is placed in service. Once you make this election, you can never revoke it.

For property placed in service during 2025, you make the election to use ADS by entering the depreciation on Form 4562, Part III, Section C, line 20c.

Property Classes Under GDS

Each item of property that can be depreciated under MACRS is assigned to a property class, determined by its class life. The property class generally determines the depreciation method, recovery period, and convention.

The property classes under GDS are:

- 3-year property,
- 5-year property,
- 7-year property,

- 10-year property,
- 15-year property,
- 20-year property,
- Nonresidential real property, and
- Residential rental property.

Under MACRS, property that you placed in service during 2025 in your rental activities generally falls into one of the following classes.

- ***5-year property.*** This class includes computers and peripheral equipment, office machinery (typewriters, calculators, copiers, etc.), automobiles, and light trucks.

This class also includes appliances, carpeting, and furniture used in a residential rental real estate activity.

Depreciation is limited on automobiles and other property used for transportation and

property of a type generally used for entertainment, recreation, or amusement. See chapter 5 of Pub. 946.

- ***7-year property.*** This class includes office furniture and equipment (desks, file cabinets, and similar items). This class also includes any property that doesn't have a class life and that hasn't been designated by law as being in any other class.
- ***15-year property.*** This class includes roads, fences, and shrubbery (if depreciable).
- ***Residential rental property.*** This class includes any real property that is a rental building or structure (including a mobile home) for which 80% or more of the gross rental income for the tax year is from dwelling units. It doesn't include a unit in a hotel, motel, inn, or other establishment where more than half of the units are used on a transient basis.

If you live in any part of the building or structure, the gross rental income includes the fair rental value of the part you live in.



The other property classes generally don't apply to property used in rental activities. These classes aren't discussed in this publication. See Pub. 946 for more information.

Recovery Periods Under GDS

The recovery period of property is the number of years over which you recover its cost or other basis. The recovery periods are generally longer under ADS than GDS.

The recovery period of property depends on its property class. Under GDS, the recovery period of an asset is generally the same as its property class.

Class lives and recovery periods for most assets are listed in *Appendix B* of Pub. 946.

See Table 2-1 for recovery periods of property commonly used in residential rental activities.

Additions or improvements to property.

Treat additions or improvements you make to your depreciable rental property as separate property items for depreciation purposes.

The property class and recovery period of the addition or improvement are the ones that would apply to the original property if you had placed it in service at the same time as the addition or improvement.

The recovery period for an addition or improvement to property begins on the later of:

- The date the addition or improvement is placed in service, or
- The date the property to which the addition or improvement was made is placed in service.

Example. You own a residential rental house that you have been renting since 1999 and depreciating under MACRS. You built an addition onto the house and placed it in service in 2025. You must begin depreciating the addition in 2025 using MACRS. Under GDS, the addition is depreciated as residential rental property over 27.5 years.

Conventions

A convention is a method established under MACRS to set the beginning and end of the recovery period. The convention you use determines the number of months for which you can claim depreciation in the year you place property in service and in the year you dispose of the property.

Mid-month convention. A mid-month convention is used for all residential rental property and nonresidential real property.