

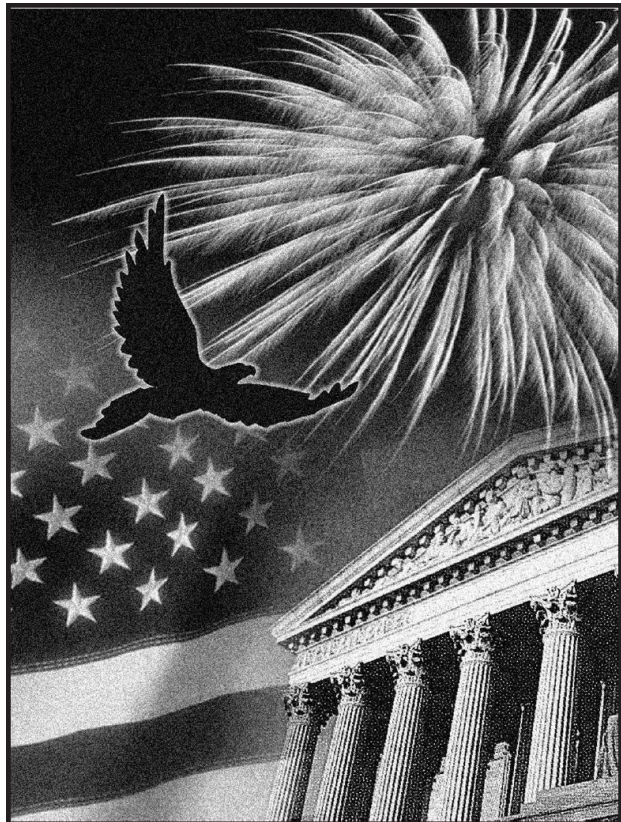
Publication 527

Residential Rental Property (Including Rental of Vacation Homes)

For use in preparing

2025 Returns

Volume 2 of 3



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Under this convention, you treat all property placed in service, or disposed of, during any month as placed in service, or disposed of, at the midpoint of that month.

Mid-quarter convention. A mid-quarter convention must be used if the mid-month convention doesn't apply and the total depreciable basis of MACRS property placed in service in the last 3 months of a tax year (excluding nonresidential real property, residential rental property, and property placed in service and disposed of in the same year) is more than 40% of the total basis of all such property you place in service during the year.

Under this convention, you treat all property placed in service, or disposed of, during any quarter of a tax year as placed in service, or disposed of, at the midpoint of the quarter.

Example. During the tax year, you purchased the following items to use in your rental property.

You elect not to claim the special depreciation allowance discussed earlier.

- A dishwasher for \$400 that you placed in service in January.
- Used furniture for \$100 that you placed in service in September.
- A refrigerator for \$800 that you placed in service in October.

You use the calendar year as your tax year. The total basis of all property placed in service that year is \$1,300. The \$800 basis of the refrigerator placed in service during the last 3 months of your tax year exceeds \$520 ($40\% \times \$1,300$). You must use the mid-quarter convention instead of the half-year convention for all three items.

Table 2-1. **MACRS Recovery Periods for Property Used in Rental Activities**

Keep for Your Records 

Type of Property	MACRS Recovery Period	
	General Depreciation System	Alternative Depreciation System
Computers and their peripheral equipment	5 years	5 years
Office machinery, such as:		
• Typewriters		
• Calculators		
• Copiers	5 years	6 years
Automobiles	5 years	5 years
Light trucks	5 years	5 years
Appliances, such as:		
• Stoves		
• Refrigerators	5 years	9 years
Carpets	5 years	9 years
Furniture used in rental property	5 years	9 years
Office furniture and equipment, such as:		
• Desks		
• Files	7 years	10 years
Any property that doesn't have a class life and that hasn't been designated by law as being in any other class	7 years	12 years
Roads	15 years	20 years
Shrubbery	15 years	20 years
Fences	15 years	20 years
Residential rental property (buildings or structures) and structural components such as furnaces, waterpipes, venting, etc.	27.5 years	30 years ¹
Additions and improvements, such as a new roof	The same recovery period as that of the property to which the addition or improvement is made, determined as if the property were placed in service at the same time as the addition or improvement.	

¹ 40 years for property placed in service before January 1, 2018. However, the ADS recovery period for residential rental property placed in service before January 1, 2018, is 30 years if the property is held by an electing real property trade or business (as defined in section 163(j)(7)(B)) and section 168(g)(1)(A), (B), (C), (D), or (E) did not apply to the property before January 1, 2018.

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Half-year convention. The half-year convention is used if neither the mid-quarter convention nor the mid-month convention applies. Under this convention, you treat all property placed in service, or disposed of, during a tax year as placed in service, or disposed of, at the midpoint of that tax year.

If this convention applies, you deduct a half year of depreciation for the first year and the last year that you depreciate the property. You deduct a full year of depreciation for any other year during the recovery period.

Figuring Your Depreciation Deduction

You can figure your MACRS depreciation deduction in one of two ways. The deduction is substantially the same both ways. You can figure the deduction using either:

- The depreciation method and convention that apply over the recovery period of the property, or

- The percentage from the MACRS percentage tables.

In this publication, we will use the percentage tables. For instructions on how to compute the deduction, see chapter 4 of Pub. 946.

Residential rental property. You must use the straight line method and a mid-month convention for residential rental property. In the first year that you claim depreciation for residential rental property, you can claim depreciation only for the number of months the property is in use. Use the mid-month convention (explained under Conventions, earlier).

5-, 7-, or 15-year property. For property in the 5- or 7-year class, use the 200% declining balance (DB) method and a half-year convention. However, in limited cases, you must use the mid-quarter convention, if it applies.

For property in the 15-year class, use the 150% DB method and a half-year convention, unless the mid-quarter convention applies.

You can also choose to use the 150% DB method for property in the 5- or 7-year class. The choice to use the 150% method for one item in a class of property applies to all property in that class that is placed in service during the tax year of the election. You make this election on Form 4562. In Part III, column (f), enter "150 DB." Once you make this election, you can't change to another method.

If you use either the 200% or 150% DB method, figure your deduction using the straight line method in the first tax year that the use of the straight line method gives you an equal or larger deduction than the use of the 200% or 150% DB method.

You can also choose to use the straight line method with a half-year or mid-quarter convention for 5-, 7-, or 15-year property.

The choice to use the straight line method for one item in a class of property applies to all property in that class that is placed in service during the tax year of the election. You elect the straight line method on Form 4562. In Part III, column (f), enter "S/L." Once you make this election, you can't change to another method.

MACRS Percentage Tables

You can use the percentages in Table 2-2 to compute annual depreciation under MACRS. The tables show the percentages for the first few years or until the change to the straight line method is made. See *Appendix A* of Pub. 946 for complete tables. The percentages in Tables 2-2a, 2-2b, and 2-2c make the change from using the DB method to the straight line method in the first tax year that the use of the straight line method gives you an equal or greater deduction than the use of the DB method.

If you elect to use the straight line method for 5-, 7-, or 15-year property, or the 150% DB method for 5- or 7-year property, use the tables in *Appendix A* of Pub. 946.

How to use the percentage tables. You must apply the table rates to your property's unadjusted basis (defined later) each year of the recovery period.

Once you begin using a percentage table to figure depreciation, you must continue to use it for the entire recovery period unless there is an adjustment to the basis of your property for a reason other than:

1. Depreciation allowed or allowable, or
2. An addition or improvement that is depreciated as a separate item of property.

If there is an adjustment for any reason other than (1) or (2), for example, because of a deductible casualty loss, you can no longer use the table.

For the year of the adjustment and for the remaining recovery period, figure depreciation using the property's adjusted basis at the end of the year and the appropriate depreciation method, as explained earlier under *Figuring Your Depreciation Deduction*. See *Figuring the Deduction Without Using the Tables* in chapter 4 of Pub. 946.

Unadjusted basis. This is the same basis you would use to figure gain on a sale (see *Basis of Depreciable Property*, earlier), but without reducing your original basis by any MACRS depreciation taken in earlier years.

However, you do reduce your original basis by other amounts claimed on the property, including:

- Any amortization,
- Any section 179 deduction, and
- Any special depreciation allowance.

For more information, see chapter 4 of Pub. 946.

Tables 2-2a, 2-2b, and 2-2c. The percentages in these tables take into account the half-year and mid-quarter conventions. Use Table 2-2a for 5-year property, Table 2-2b for 7-year property, and Table 2-2c for 15-year property. Use the percentage in the second column (half-year convention) unless you are required to use the mid-quarter convention (explained earlier). If you must use the mid-quarter convention, use the column that corresponds to the calendar year quarter in which you placed the property in service.

Example 1. You purchased a stove and refrigerator and placed them in service in June. Your basis in the stove is \$600 and your basis in the refrigerator is \$1,000. Both are 5-year property.

Using the half-year convention column in Table 2-2a, the depreciation percentage for Year 1 is 20%. For that year, your depreciation deduction is \$120 ($\$600 \times 20\%$ (0.20)) for the stove and \$200 ($\$1,000 \times 20\%$ (0.20)) for the refrigerator.

For Year 2, the depreciation percentage is 32%. That year's depreciation deduction will be \$192 ($\$600 \times 32\%$ (0.32)) for the stove and \$320 ($\$1,000 \times 32\%$ (0.32)) for the refrigerator.

Example 2. Assume the same facts as in *Example 1*, except you buy the refrigerator in October instead of June. Because the refrigerator was placed in service in the last 3 months of the tax year, and its basis (\$1,000) is more than 40% of the total basis of all property placed in service during the year ($\$1,600 \times 40\%$ (0.40) = \$640), you are required to use the mid-quarter convention to figure depreciation on both the stove and refrigerator.

Table 2-2. **Optional MACRS GDS Percentage Tables**

a. MACRS 5-Year Property (200% DB)

	Half-year convention	Mid-quarter convention			
Year		First quarter	Second quarter	Third quarter	Fourth quarter
1	20.00%	35.00%	25.00%	15.00%	5.00%
2	32.00	26.00	30.00	34.00	38.00
3	19.20	15.60	18.00	20.40	22.80
4	11.52	11.01	11.37	12.24	13.68
5	11.52	11.01	11.37	11.30	10.94
6	5.76	1.38	4.26	7.06	9.58

b. MACRS 7-Year Property (200% DB)

	Half-year convention	Mid-quarter convention			
Year		First quarter	Second quarter	Third quarter	Fourth quarter
1	14.29%	25.00%	17.85%	10.71%	3.57%
2	24.49	21.43	23.47	25.51	27.55
3	17.49	15.31	16.76	18.22	19.68
4	12.49	10.93	11.97	13.02	14.06
5	8.93	8.75	8.87	9.30	10.04
6	8.92	8.74	8.87	8.85	8.73
7	8.93	8.75	8.87	8.86	8.73

c. MACRS 15-Year Property (150% DB)

	Half-year convention	Mid-quarter convention			
Year		First quarter	Second quarter	Third quarter	Fourth quarter
1	5.00%	8.75%	6.25%	3.75%	1.25%
2	9.50	9.13	9.38	9.63	9.88
3	8.55	8.21	8.44	8.66	8.89
4	7.70	7.39	7.59	7.80	8.00
5	6.93	6.65	6.83	7.02	7.20
6	6.23	5.99	6.15	6.31	6.48
7	5.90	5.90	5.91	5.90	5.90
8	5.90	5.91	5.90	5.90	5.90

d. Residential Rental Property-GDS (27.5-year S/L with mid-month convention)

	Use the row for the month of the taxable year placed in service.					
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Jan.	3.485%	3.636%	3.636%	3.636%	3.636%	3.636%
Feb.	3.182	3.636	3.636	3.636	3.636	3.636
March	2.879	3.636	3.636	3.636	3.636	3.636
Apr.	2.576	3.636	3.636	3.636	3.636	3.636
May	2.273	3.636	3.636	3.636	3.636	3.636
June	1.970	3.636	3.636	3.636	3.636	3.636
July	1.667	3.636	3.636	3.636	3.636	3.636
Aug.	1.364	3.636	3.636	3.636	3.636	3.636
Sept.	1.061	3.636	3.636	3.636	3.636	3.636
Oct.	0.758	3.636	3.636	3.636	3.636	3.636
Nov.	0.455	3.636	3.636	3.636	3.636	3.636
Dec.	0.152	3.636	3.636	3.636	3.636	3.636

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Because you placed the refrigerator in service in October, you use the fourth quarter column of Table 2-2a and find the depreciation percentage for Year 1 is 5%. Your depreciation deduction for the refrigerator is \$50 ($\$1,000 \times 5\% (0.05)$).

Because you placed the stove in service in June, you use the second quarter column of Table 2-2a and find the depreciation percentage for Year 1 is 25%. For that year, your depreciation deduction for the stove is \$150 ($\$600 \times 25\% (0.25)$).

Table 2-2d. Use this table when you are using the GDS 27.5-year option for residential rental property. Find the row for the month that you placed the property in service.

Use the percentages listed for that month to figure your depreciation deduction. The mid-month convention is taken into account in the percentages shown in the table. Continue to use the same row (month) under the column for the appropriate year.

Example. You purchased a single family rental house for \$185,000 and placed it in service on February 8. The sales contract showed that the building cost \$160,000 and the land cost \$25,000. Your basis for depreciation is its original cost, \$160,000. This is the first year of service for your residential rental property and you decide to use GDS, which has a recovery period of 27.5 years. Using Table 2-2d, you find that the depreciation percentage for property placed in service in February of Year 1 is 3.182%. That year's depreciation deduction is \$5,091 ($\$160,000 \times 3.182\% (0.03182)$).

Figuring MACRS Depreciation Under ADS

Table 2-1 shows the ADS recovery periods for property used in rental activities.

See *Appendix B* of Pub. 946 for other property. If your property isn't listed in *Appendix B*, it is considered to have no class life.

Under ADS, personal property with no class life is depreciated using a recovery period of 12 years.

Use the mid-month convention for residential rental property and nonresidential real property. For all other property, use the half-year or mid-quarter convention, as appropriate.

See Pub. 946 for ADS depreciation tables.

Claiming the Correct Amount of Depreciation

You should claim the correct amount of depreciation each tax year. If you didn't claim all the depreciation you were entitled to deduct, you must still reduce your basis in the property by the full amount of depreciation that you could have deducted. For more information, see *Depreciation* under *Decreases to Basis* in Pub. 551.

If you deducted an incorrect amount of depreciation for property in any year, you may be able to make a correction by filing Form 1040-X, Amended U.S. Individual Income Tax Return. If you aren't allowed to make the correction on an amended return, you may be able to change your accounting method to claim the correct amount of depreciation. See *How Do You Correct Depreciation Deductions?* in Pub. 946 for more information.

3.

Reporting Rental Income, Expenses, and Losses

Figuring the net income or loss for a residential rental activity may involve more than just listing the income and deductions on Schedule E (Form 1040).

There are activities that don't qualify to use Schedule E, such as when the activity isn't engaged in to make a profit or when you provide substantial services in conjunction with the property.

There are also the limitations that may need to be applied if you have a net loss on Schedule E. There are two: (1) the limitation based on the amount of investment you have at risk in your rental activity, and (2) the special limits imposed on passive activities.

You may also have a gain or loss related to your rental property from a casualty or theft. This is considered separately from the income and expense information you report on Schedule E.

Which Forms To Use

The basic form for reporting residential rental income and expenses is Schedule E (Form 1040). However, don't use that schedule to report a not-for-profit activity.

See *Not Rented for Profit*, later, in chapter 4. There are also other rental situations in which forms other than Schedule E would be used.

Schedule E (Form 1040)

If you rent buildings, rooms, or apartments, and provide basic services such as heat and light, trash collection, etc., you normally report your rental income and expenses on Schedule E, Part I.

List your total income, expenses, and depreciation for each rental property. Be sure to enter the number of fair rental and personal-use days on line 2.

If you have more than three rental or royalty properties, complete and attach as many Schedules E as are needed to separately list all of the properties. However, fill in lines 23a through 26 on only one Schedule E. The figures on lines 23a through 26 on that Schedule E should be the combined totals for all properties reported on your Schedules E.

On Schedule E, page 1, line 18, enter the depreciation you are claiming for each property. You may also need to attach Form 4562 to claim some or all of your depreciation. See Form 4562, later, for more information.

If you have a loss from your rental real estate activity, you may also need to complete one or both of the following forms.

- Form 6198, At-Risk Limitations. See At-Risk Rules, later. Also, see Pub. 925.
- Form 8582, Passive Activity Loss Limitations. See Passive Activity Limits, later.

Page 2 of Schedule E is used to report income or loss from partnerships, S corporations, estates, trusts, and real estate mortgage investment conduits. If you need to use page 2 of Schedule E and you have more than three rental or royalty properties, be sure to use page 2 of the same Schedule E you used

to enter the combined totals for your rental activity on page 1. Also, include the amount from line 26 (Part I) in the “Total income or (loss)” on line 41 (Part V).

Form 4562. You must complete and attach Form 4562 if you are claiming the following depreciation in your rental activity.

- Depreciation, including the special depreciation allowance, on property placed in service during 2025.
- Depreciation on listed property (such as a car), regardless of when it was placed in service.

Otherwise, figure your depreciation on your own worksheet. You don’t have to attach these computations to your return, but you should keep them in your records for future reference.

You may also need to attach Form 4562 if you are claiming a section 179 deduction, amortizing costs that began during 2025,

or claiming any other deduction for a vehicle, including the standard mileage rate or lease expenses.

See Pub. 946 for information on preparing Form 4562.

Schedule C (Form 1040), Profit or Loss From Business

Generally, Schedule C is used when you provide substantial services in conjunction with the property or the rental is part of a trade or business as a real estate dealer.

Providing substantial services. If you provide substantial services that are primarily for your tenant's convenience, such as regular cleaning, changing linen, or maid service, you report your rental income and expenses on Schedule C. Use Form 1065, U.S. Return of Partnership Income, if your rental activity is a partnership (including a partnership with your spouse unless it is a qualified joint venture).

Substantial services don't include the furnishing of heat and light, cleaning of public areas, trash collection, etc. For more information, see Pub. 334, *Tax Guide for Small Business*. Also, you may have to pay self-employment tax on your rental income using Schedule SE (Form 1040), *Self-Employment Tax*. For a discussion of "substantial services," see *Real Estate Rents* in chapter 5 of Pub. 334.

Qualified Joint Venture (QJV)

If you and your spouse each materially participate (see *Material participation* under *Passive Activity Limits*, later) as the only members of a jointly owned and operated real estate business, and you file a joint return for the tax year, you can make a joint election to be treated as a QJV instead of a partnership. This election, in most cases, won't increase the total tax owed on the joint return, but it does give each of you credit for social security

earnings on which retirement benefits are based and for Medicare coverage if your rental income is subject to self-employment tax.

If you make this election, you must report rental real estate income on Schedule E (or Schedule C, if you provide substantial services). You won't be required to file Form 1065 for any year the election is in effect. Rental real estate income generally isn't included in net earnings from self-employment subject to self-employment tax and is generally subject to the passive activity limits.

If you and your spouse filed a Form 1065 for the year prior to the election, the partnership terminates at the end of the tax year immediately preceding the year the election takes effect.

For more information on QJVs, go to [IRS.gov/QJV](https://www.irs.gov/QJV).

Limits on Rental Losses

If you have a loss from your rental real estate activity, two sets of rules may limit the amount of loss you can report on Schedule E. You must consider these rules in the order shown below. Both are discussed in this section.

1. At-risk rules. These rules are applied first if there is investment in your rental real estate activity for which you aren't at risk. This applies only if the real property was placed in service after 1986.
2. Passive activity limits. Generally, rental real estate activities are considered passive activities and losses aren't deductible unless you have income from other passive activities to offset them. However, there are exceptions.

Excess business loss limitation. In addition to at-risk rules and passive activity limits, excess business loss rules apply to losses from all noncorporate trades or businesses. This business loss limitation is figured using Form 461 after you complete your Schedule E. Any limitation to your loss resulting from these rules will not be reflected on your Schedule E. Instead, it will be added to your income on Form 1040 or 1040-SR and treated as a net operating loss that must be carried forward and deducted in a subsequent year.

At-Risk Rules

You may be subject to the at-risk rules if you have:

- A loss from an activity carried on as a trade or business or for the production of income, and
- Amounts invested in the activity for which you aren't fully at risk.

Losses from holding real property (other than mineral property) placed in service before 1987 aren't subject to the at-risk rules.

In most cases, any loss from an activity subject to the at-risk rules is allowed only to the extent of the total amount you have at risk in the activity at the end of the tax year. You are considered at risk in an activity to the extent of cash and the adjusted basis of other property you contributed to the activity and certain amounts borrowed for use in the activity. Any loss that is disallowed because of the at-risk limits is treated as a deduction from the same activity in the next tax year. See Pub. 925 for a discussion of the at-risk rules.

Form 6198. If you are subject to the at-risk rules, file Form 6198 with your tax return.

Passive Activity Limits

In most cases, all rental real estate activities (except those of certain real estate

professionals, discussed later) are passive activities. For this purpose, a rental activity is an activity from which you receive income mainly for the use of tangible property, rather than for services. For a discussion of activities that aren't considered rental activities, see *Rental Activities* in Pub. 925.

Deductions or losses from passive activities are limited. You generally can't offset income, other than passive income, with losses from passive activities. Nor can you offset taxes on income, other than passive income, with credits resulting from passive activities. Any excess loss or credit is carried forward to the next tax year. Exceptions to the rules for figuring passive activity limits for personal use of a dwelling unit and for rental real estate with active participation are discussed later.

For a detailed discussion of these rules, see Pub. 925.

Real estate professionals. If you are a real estate professional, complete line 43 of Schedule E.

You qualify as a real estate professional for the tax year if you meet both of the following requirements.

- More than half of the personal services you perform in all trades or businesses during the tax year are performed in real property trades or businesses in which you materially participate.
- You perform more than 750 hours of services during the tax year in real property trades or businesses in which you materially participate.

If you qualify as a real estate professional, rental real estate activities in which you materially participated aren't passive activities. For purposes of determining whether you materially participated in your rental real estate activities,

each interest in rental real estate is a separate activity unless you elect to treat all your interests in rental real estate as one activity.

Don't count personal services you perform as an employee in real property trades or businesses unless you are a 5% owner of your employer. You are a 5% owner if you own (or are considered to own) more than 5% of your employer's outstanding stock, or capital or profits interest.

Don't count your spouse's personal services to determine whether you met the requirements listed earlier to qualify as a real estate professional. However, you can count your spouse's participation in an activity in determining if you materially participated.

Real property trades or businesses. A real property trade or business is a trade or business that does any of the following with real property.

- Develops or redevelops it.
- Constructs or reconstructs it.
- Acquires it.
- Converts it.
- Rents or leases it.
- Operates or manages it.
- Brokers it.

Choice to treat all interests as one activity. If you were a real estate professional and had more than one rental real estate interest during the year, you can choose to treat all the interests as one activity. You can make this choice for any year that you qualify as a real estate professional. If you forgo making the choice for one year, you can still make it for a later year.

If you make the choice, it is binding for the tax year you make it and for any later year that you are a real estate professional. This is true even if you aren't a real estate professional in any intervening year. (For that year, the exception for real estate professionals won't apply in determining whether your activity is subject to the passive activity rules.)

See the Instructions for Schedule E for information about making this choice.

Material participation. Generally, you materially participated in an activity for the tax year if you were involved in its operations on a regular, continuous, and substantial basis during the year. For details, see Pub. 925 or the Instructions for Schedule C.

Participating spouse. If you are married, determine whether you materially participated in an activity by also counting any participation in the activity by your spouse during the year.

Do this even if your spouse owns no interest in the activity or files a separate return for the year.

Form 8582. You may have to complete Form 8582 to figure the amount of any passive activity loss for the current tax year for all activities and the amount of the passive activity loss allowed on your tax return. See *Form 8582 not required*, later in this chapter, to determine if you must complete Form 8582.

If you are required to complete Form 8582 and are also subject to the at-risk rules, include the amount from Form 6198, line 21 (deductible loss), in column (b) of Form 8582, Worksheet 1 or 2, as required.

Exception for Personal Use of Dwelling Unit

If you used the rental property as a home during the year, any income, deductions, gain, or loss allocable to such use is not to be

taken into account for purposes of the passive activity loss limitation. Instead, follow the rules explained in chapter 5.

Exception for Rental Real Estate With Active Participation

If you or your spouse actively participated in a passive rental real estate activity, you may be able to deduct up to \$25,000 of loss from the activity from your nonpassive income.

This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities. Similarly, you may be able to offset credits from the activity against the tax on up to \$25,000 of nonpassive income after taking into account any losses allowed under this exception.

Example. You are single and have \$40,000 in wages, \$2,000 of passive income from a limited partnership, and \$3,500 of passive loss from a rental real estate activity in which you actively participated. \$2,000 of your \$3,500 loss offsets your passive income.

The remaining \$1,500 loss can be deducted from your \$40,000 wages.



The special allowance isn't available if you were married, lived with your spouse at any time during the year, and are filing a separate return.

Active participation. You actively participated in a rental real estate activity if you (and your spouse) owned at least 10% of the rental property and you made management decisions or arranged for others to provide services (such as repairs) in a significant and bona fide sense. Management decisions that may count as active participation include approving new tenants, deciding on rental terms, approving expenditures, and other similar decisions.

Example. You are single and had the following income and losses during the tax year.

Salary	\$42,300
Dividends	300
Interest	1,400
Rental loss	(4,000)

The rental loss was from the rental of a house you owned. You had advertised and rented the house to the current tenant yourself. You also collected the rents, which usually came by mail. You made or contracted out all repairs.

Although the rental loss is from a passive activity, because you actively participated in the rental property management, you can use the entire \$4,000 loss to offset your other income.

Maximum special allowance. The maximum special allowance is:

- \$25,000 for single individuals and married individuals filing a joint return for the tax year,
- \$12,500 for married individuals who file separate returns for the tax year and lived apart from their spouses at all times during the tax year, and
- \$25,000 for a qualifying estate reduced by the special allowance for which the surviving spouse qualified.

If your MAGI is \$100,000 or less (\$50,000 or less if married filing separately), you can deduct your loss up to the amount specified above. If your MAGI is more than \$100,000 (more than \$50,000 if married filing separately), your special allowance is limited to 50% of the difference between \$150,000 (\$75,000 if married filing separately) and your MAGI.

Generally, if your MAGI is \$150,000 or more (\$75,000 or more if you are married filing separately), there is no special allowance.

Modified adjusted gross income (MAGI).

For more information on the definition of MAGI, see *Special \$25,000 allowance* in Pub. 925. Also see *Line 6* in the Instructions for Form 8582.

Form 8582 not required. Don't complete Form 8582 if you meet all of the following conditions.

- Your only passive activities were rental real estate activities in which you actively participated.
- Your overall net loss from these activities is \$25,000 or less (\$12,500 or less if married filing separately and you lived apart from your spouse all year).
- If married filing separately, you lived apart from your spouse all year.

- You have no prior-year unallowed losses from these (or any other passive) activities.
- You have no current or prior-year unallowed credits from passive activities.
- Your MAGI is \$100,000 or less (\$50,000 or less if married filing separately and you lived apart from your spouse all year).
- You don't hold any interest in a rental real estate activity as a limited partner or as a beneficiary of an estate or a trust.

If you meet all of the conditions listed above, your rental real estate activities aren't limited by the passive activity rules and you don't have to complete Form 8582. On lines 23a through 23e of your Schedule E, enter the applicable amounts.

Casualties and Thefts

As a result of a casualty or theft, you may have a loss related to your rental property.

You may be able to deduct the loss on your income tax return.

Casualty. This is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual. Such events include a storm, fire, or earthquake.

Theft. This is defined as the unlawful taking and removing of your money or property with the intent to deprive you of it.

Gain from casualty or theft. It is also possible to have a gain from a casualty or theft if you receive money, including insurance, that is more than your adjusted basis in the property. Generally, you must report this gain. However, under certain circumstances, you may defer paying tax by choosing to postpone reporting the gain. To do this, you must generally buy replacement property within 2 years after the close of the first tax year in which any part of your gain is realized.

In certain circumstances, the replacement period can be greater than 2 years; see *Replacement Period* in Pub. 547 for more information. The cost of the replacement property must be equal to or more than the net insurance or other payment you received.

More information. For information on business and nonbusiness casualty and theft losses, see Pub. 547.

How to report. If you had a casualty or theft that involved property used in your rental activity, figure the net gain or loss in Section B of Form 4684, Casualties and Thefts. Follow the Instructions for Form 4684 for where to carry your net gain or loss.

Example

In February 2020, you bought a rental house for \$135,000 (house \$120,000 and land \$15,000) and immediately began renting it out. In 2025, you rented it all 12 months for a monthly rental fee of \$1,125.

In addition to your rental income of \$13,500 (12 x \$1,125), you had the following expenses.

Mortgage interest	\$8,000
Fire insurance (1-year policy) . .	250
Miscellaneous repairs	400
Real estate taxes imposed and paid	500
Maintenance	200

You depreciate the residential rental property under MACRS GDS. This means using the straight line method over a recovery period of 27.5 years.

You use Table 2-2d to find your depreciation percentage. Because you placed the property in service in February 2020, you continue to use that row of Table 2-2d. For Year 6, the rate is 3.636%.

You figure your net rental income or loss for the house as follows.

Total rental income received (\$1,125 × 12).....	\$13,500
Minus: Expenses	
Mortgage interest ...	\$8,000
Fire insurance	250
Miscellaneous repairs.	400
Real estate taxes ..	500
Maintenance	<u>200</u>
Total expenses.....	<u>9,350</u>
Balance.....	\$4,150
Minus: Depreciation (\$120,000 × 3.636% (0.03636)).....	<u>4,363</u>
Net rental (loss) for house..	<u>(\$213)</u>

You had a net loss for the year. Because you actively participated in your passive rental real estate activity and your loss was less than \$25,000, you can deduct the loss on your return. You also meet all of the requirements for not having to file Form 8582. You use Schedule E, Part I, to report your rental income and expenses. You enter your income, expenses, and depreciation for the house in the column for Property A and enter your loss on line 22. Form 4562 isn't required.

4.

Special Situations

This chapter discusses some rental real estate activities that are subject to additional rules.

Condominiums

A condominium is most often a dwelling unit in a multi-unit building, but can also take

other forms, such as a townhouse or garden apartment.

If you own a condominium, you also own a share of the common elements, such as land, lobbies, elevators, and service areas. You and the other condominium owners may pay dues or assessments to a special corporation that is organized to take care of the common elements.

Special rules apply if you rent your condominium to others. You can deduct as rental expenses all the expenses discussed in chapters 1 and 2. In addition, you can deduct any dues or assessments paid for maintenance of the common elements.

You can't deduct special assessments you pay to a condominium management corporation for improvements. However, you may be able to recover your share of the cost of any improvement by taking depreciation.

Cooperatives

If you live in a cooperative, you don't own your apartment. Instead, a corporation owns the apartments and you are a tenant-stockholder in the cooperative housing corporation. If you rent your apartment to others, you can usually deduct, as a rental expense, all the maintenance fees you pay to the cooperative housing corporation.

In addition to the maintenance fees paid to the cooperative housing corporation, you can deduct your direct payments for repairs, upkeep, and other rental expenses, including interest paid on a loan used to buy your stock in the corporation.

Depreciation

You will be depreciating your stock in the corporation rather than the apartment itself. Figure your depreciation deduction as follows.

1. Figure the depreciation for all the depreciable real property owned by the corporation. (Depreciation methods are discussed in chapter 2 of this publication and Pub. 946.) If you bought your cooperative stock after its first offering, figure the depreciable basis of this property as follows.
 - a. Multiply your cost per share by the total number of outstanding shares.
 - b. Add to the amount figured in (a) any mortgage debt on the property on the date you bought the stock.
 - c. Subtract from the amount figured in (b) any mortgage debt that isn't for the depreciable real property, such as the part for the land.

2. Subtract from the amount figured in (1) any depreciation for space owned by the corporation that can be rented but can't be lived in by tenant-stockholders.
3. Divide the number of your shares of stock by the total number of shares outstanding, including any shares held by the corporation.
4. Multiply the result of (2) by the percentage you figured in (3). This is your depreciation on the stock.

Your depreciation deduction for the year can't be more than the part of your adjusted basis (defined in chapter 2) in the stock of the corporation that is allocable to your rental property.

Payments added to capital account.

Payments earmarked for a capital asset or improvement, or otherwise charged to the corporation's capital account,

are added to the basis of your stock in the corporation. For example, you can't deduct a payment used to pave a community parking lot, install a new roof, or pay the principal of the corporation's mortgage.

Treat as a capital cost the amount you were assessed for capital items. This can't be more than the amount by which your payments to the corporation exceeded your share of the corporation's mortgage interest and real estate taxes.

Your share of interest and taxes is the amount the corporation elected to allocate to you, if it reasonably reflects those expenses for your apartment. Otherwise, figure your share in the following manner.

1. Divide the number of your shares of stock by the total number of shares outstanding, including any shares held by the corporation.

2. Multiply the corporation's deductible interest by the number you figured in (1). This is your share of the interest.
3. Multiply the corporation's deductible taxes by the number you figured in (1). This is your share of the taxes.

Property Changed to Rental Use

If you change your home or other property (or a part of it) to rental use at any time other than the beginning of your tax year, you must divide yearly expenses, such as taxes and insurance, between rental use and personal use.

You can deduct as rental expenses only the part of the expense that is for the part of the year the property was used or held for rental purposes.

You can't deduct depreciation or insurance for the part of the year the property was held for personal use.

However, you can include the home mortgage interest and real estate tax expenses for the part of the year the property was held for personal use when figuring the amount you can deduct on Schedule A.

Example. Your tax year is the calendar year. You moved from your home in May and started renting it out on June 1. You can deduct as rental expenses seven-twelfths of your yearly expenses, such as taxes and insurance.

Starting with June, you can deduct as rental expenses the amounts you pay for items generally billed monthly, such as utilities.

When figuring depreciation, treat the property as placed in service on June 1.

Basis of Property Changed to Rental Use

When you change property you held for personal use to rental use (for example, you rent your former home),

the basis for depreciation will be the lesser of the FMV or adjusted basis on the date of conversion.

FMV. This is the price at which the property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all the relevant facts. Sales of similar property, on or about the same date, may be helpful in figuring the FMV of the property.

Figuring the basis. The basis for depreciation is the lesser of:

- The FMV of the property on the date you changed it to rental use; or
- Your adjusted basis on the date of the change—that is, your original cost or other basis of the property, plus the cost of permanent additions or improvements since you acquired it, minus deductions for any casualty or theft losses claimed on earlier years' income tax returns and

other decreases to basis. For other increases and decreases to basis, see Adjusted Basis in chapter 2.

Example. You originally built a house for \$140,000 on a lot that cost you \$14,000, which you used as your home for many years. Before changing the property to rental use this year, you added \$28,000 of permanent improvements to the house and claimed a \$3,500 casualty loss deduction for damage to the house. Part of the improvements qualified for a \$500 residential energy credit, which you claimed on a prior-year tax return. Because land isn't depreciable, you can only include the cost of the house when figuring the basis for depreciation.

The adjusted basis of the house at the time of the change in its use was \$164,000 (\$140,000 + \$28,000 – \$3,500 – \$500).

On the date of the change in use, your property had an FMV of \$168,000, of which \$21,000 was for the land and \$147,000 was for the house.

The basis for depreciation on the house is the FMV on the date of the change (\$147,000) because it is less than your adjusted basis (\$164,000).

Cooperatives

If you change your cooperative apartment to rental use, figure your allowable depreciation as explained earlier. (Depreciation methods are discussed in chapter 2 of this publication and Pub. 946.) The basis of all the depreciable real property owned by the cooperative housing corporation is the smaller of the following amounts.

- The FMV of the property on the date you change your apartment to rental use.

This is considered to be the same as the corporation's adjusted basis minus straight line depreciation, unless this value is unrealistic.

- The corporation's adjusted basis in the property on that date. Don't subtract depreciation when figuring the corporation's adjusted basis.

If you bought the stock after its first offering, the corporation's adjusted basis in the property is the amount figured in (1) under Depreciation, earlier. The FMV of the property is considered to be the same as the corporation's adjusted basis figured in this way minus straight line depreciation, unless the value is unrealistic.

Figuring the Depreciation Deduction

To figure the deduction, use the depreciation system in effect when you convert your residence to rental use.

Generally, that will be MACRS for any conversion after 1986. Treat the property as placed in service on the conversion date.

Example. Your converted residence (see the previous example under *Figuring the basis*, earlier) was available for rent on August 1. Using Table 2-2d (see chapter 2), the percentage for Year 1 beginning in August is 1.364% and the depreciation deduction for Year 1 is \$2,005 ($\$147,000 \times 1.364\%$ (0.01364)).

Renting Part of Property

If you rent part of your property, you must divide certain expenses between the part of the property used for rental purposes and the part of the property used for personal purposes, as though you actually had two separate pieces of property.

You can deduct the expenses related to the part of the property used for rental purposes, such as home mortgage interest and real

estate taxes, as rental expenses on Schedule E (Form 1040). You can also deduct as rental expenses a portion of other expenses that are normally nondeductible personal expenses, such as expenses for electricity or painting the outside of the house.

There is no change in the types of expenses deductible for the personal-use part of your property. Generally, these expenses may be deducted only if you itemize your deductions on Schedule A (Form 1040).

You can't deduct any part of the cost of the first phone line even if your tenants have unlimited use of it.

You don't have to divide the expenses that belong only to the rental part of your property. For example, if you paint a room that you rent or pay premiums for liability insurance in connection with renting a room in your home, your entire cost is a rental expense.

If you install a second phone line strictly for your tenant's use, all the cost of the second line is deductible as a rental expense.

You can deduct depreciation on the part of the house used for rental purposes as well as on the furniture and equipment you use for rental purposes.

How to divide expenses. If an expense is for both rental use and personal use, such as mortgage interest or heat for the entire house, you must divide the expense between rental use and personal use. You can use any reasonable method for dividing the expense. It may be reasonable to divide the cost of some items (for example, water) based on the number of people using them. The two most common methods for dividing an expense are (1) the number of rooms in your home, and (2) the square footage of your home.

Example. You rent a room in your house. The room is 12 × 15 feet, or 180 square feet.

Your entire house has 1,800 square feet of floor space. You can deduct as a rental expense 10% of any expense that must be divided between rental use and personal use. If your heating bill for the year for the entire house was \$600, \$60 ($\$600 \times 10\% (0.10)$) is a rental expense. The balance, \$540, is a personal expense that you can't deduct.

Duplex. A common situation is the duplex where you live in one unit and rent out the other. Certain expenses apply to the entire property, such as mortgage interest and real estate taxes, and must be split to determine rental and personal expenses.

Example. You own a duplex and live in one half, renting out the other half. Both units are approximately the same size. Last year, you paid a total of \$10,000 mortgage interest and \$2,000 real estate taxes for the entire property. You can deduct \$5,000 mortgage interest and \$1,000 real estate taxes on Schedule E.

If you itemize your deductions, include the other \$5,000 mortgage interest and \$1,000 real estate taxes when figuring the amount you can deduct on Schedule A.

Not Rented for Profit

If you don't rent your property to make a profit, you must still report your rental income, however, you can no longer deduct rental expenses.

Where to report. Report your not-for-profit rental income on Schedule 1 (Form 1040), line 8j. If you itemize your deductions, include your mortgage interest (if you use the property as your main home or second home), real estate taxes, and casualty losses from your not-for-profit rental activity when figuring the amount you can deduct on Schedule A.

Presumption of profit. If your rental income is more than your rental expenses for at least 3 years out of a period of 5 consecutive

years, you are presumed to be renting your property to make a profit.

Postponing decision. If you are starting your rental activity and don't have 3 years showing a profit, you can elect to have the presumption made after you have the 5 years of experience required by the test. You may choose to postpone the decision of whether the rental is for profit by filing Form 5213. You must file Form 5213 within 3 years after the due date of your return (determined without extensions) for the year in which you first carried on the activity or, if earlier, within 60 days after receiving written notice from the IRS proposing to disallow deductions attributable to the activity.

More information. For more information about the rules for an activity not engaged in for profit, see [*Hobby or business: here's what to know about that side hustle.*](#)

Example—Property Changed to Rental Use

In January, you bought a condominium apartment to live in. Instead of selling the house you had been living in, you decided to change it to a rental property. You selected a tenant and started renting the house on February 1. You charged \$750 a month for rent and collected it yourself. You also received a \$750 security deposit from your tenant. Because you plan to return it to your tenant at the end of the lease, you don't include it in your income. Your rental expenses for the year are as follows.

Mortgage interest.....	\$1,800
Fire insurance (1-year policy).....	100
Miscellaneous repairs (after renting).	297
Real estate taxes imposed and paid..	1,200

You must divide the real estate taxes, mortgage interest, and fire insurance between the personal use of the property and the rental use of the property. You can deduct eleven-twelfths of these expenses as rental expenses. You can include the balance of the real estate taxes and mortgage interest when figuring the amount you can deduct on Schedule A, if you itemize. You can't deduct the balance of the fire insurance because it is a personal expense.

You bought this house in 2008 for \$35,000. Your property tax was based on assessed values of \$10,000 for the land and \$25,000 for the house. Before changing it to rental property, you added several improvements to the house. You figure your adjusted basis as follows.

Improvements	Cost
House.....	\$25,000
Remodeled kitchen.....	4,200

Recreation room.....	5,800
New roof.....	1,600
Patio and deck.....	<u>2,400</u>
Adjusted basis.....	<u>\$39,000</u>

On February 1, when you changed your house to rental property, the property had an FMV of \$152,000. Of this amount, \$35,000 was for the land and \$117,000 was for the house.

Because your adjusted basis is less than the FMV on the date of the change, you use \$39,000 as your basis for depreciation.

As specified for residential rental property, you must use the straight line method of depreciation over the GDS or ADS recovery period. You choose the GDS recovery period of 27.5 years.

You use Table 2-2d to find your depreciation percentage. Because you placed the property in service in February, the percentage is 3.182%.

On April 1, you bought a new dishwasher for the rental property at a cost of \$425. The dishwasher is personal property used in a rental real estate activity, which has a 5-year recovery period. You use Table 2-2a to find the depreciation percentage for Year 1 under “Half-year convention” (20%) to figure your depreciation deduction.

On May 1, you paid \$4,000 to have a furnace installed in the house. The furnace is residential rental property. Because you placed the property in service in May, the depreciation percentage from Table 2-2d is 2.273%.

You figured your net rental income or loss for the house as follows.

You figured your net rental income or loss for the house as follows. Total rental income received ($\$750 \times 11$)..... $\$8,250$

Minus: Expenses

Mortgage interest ($\$1,800 \times 11/12$)..... $\$1,650$

Fire insurance ($\$100 \times 11/12$)..... 92

Miscellaneous repairs..... 297

Real estate taxes ($\$1,200 \times 11/12$)..... 1,100

Total expenses..... 3,139

Balance..... $\$5,111$

Minus: Depreciation

House ($\$39,000 \times 0.03182$). $\$1,241$

Dishwasher ($\$425 \times 0.20$).....	85
Furnace ($\$4,000 \times 0.02273$).....	<u>91</u>
Total depreciation.....	<u>1,417</u>
Net rental income for house.....	<u>\$3,694</u>

You use Schedule E, Part I, to report your rental income and expenses. You enter your income, expenses, and depreciation for the house in the column for Property A. Because all property was placed in service this year, you must use Form 4562 to figure the depreciation. See the instructions for Form 4562 for more information on preparing the form.

5.

Personal Use of Dwelling Unit (Including Vacation Home)

If you have any personal use of a dwelling unit (including a vacation home) that you rent, you must divide your expenses between rental use and personal use. In general, your rental expenses will be no more than your total expenses multiplied by a fraction, the denominator of which is the total number of days the dwelling unit is used and the numerator of which is the total number of days actually rented at a fair rental price. Only your rental expenses may be deducted on Schedule E (Form 1040). Some of your personal expenses may be deductible on Schedule A (Form 1040) if you itemize your deductions.

You must also determine if the dwelling unit is considered a home. The amount of rental expenses that you can deduct may be limited if the dwelling unit is considered a home.

Whether a dwelling unit is considered a home depends on how many days during the year are considered to be days of personal use.

There is a special rule if you used the dwelling unit as a home and you rented it for less than 15 days during the year.

Dwelling unit. A dwelling unit includes a house, apartment, condominium, mobile home, boat, vacation home, or similar property. It also includes all structures or other property belonging to the dwelling unit. A dwelling unit has basic living accommodations, such as sleeping space, a toilet, and cooking facilities.

A dwelling unit doesn't include property (or part of the property) used solely as a hotel, motel, inn, or similar establishment.

Property is used solely as a hotel, motel, inn, or similar establishment if it is regularly available for occupancy by paying customers and isn't used by an owner as a home during the year.

Example. You rent a room in your home that is always available for short-term occupancy by paying customers. You don't use the room yourself and you allow only paying customers to use the room. This room is used solely as a hotel, motel, inn, or similar establishment and isn't a dwelling unit.

Dividing Expenses

If you use a dwelling unit for both rental and personal purposes, divide your expenses between the rental use and the personal use based on the number of days used for each purpose.

When dividing your expenses, follow these rules.

- Any day that the unit is rented at a fair rental price is a day of rental use even if you used the unit for personal purposes that day. (This rule doesn't apply when determining whether you used the unit as a home.)
- Any day that the unit is available for rent but not actually rented isn't a day of rental use.

Fair rental price. A fair rental price for your property is generally the amount of rent that a person who isn't related to you would be willing to pay. The rent you charge isn't a fair rental price if it is substantially less than the rents charged for other properties that are similar to your property in your area.

Ask yourself the following questions when comparing another property with yours.

- Is it used for the same purpose?

- Is it approximately the same size?
- Is it in approximately the same condition?
- Does it have similar furnishings?
- Is it in a similar location?

If any of the answers are no, the properties probably aren't similar.

Example. Your beach cottage was available for rent from June 1 through August 31 (92 days). Except for the first week in August (7 days), when you were unable to find a renter, you rented the cottage at a fair rental price during that time. The person who rented the cottage for July allowed you to use it over the weekend (2 days) without any reduction in or refund of rent. Your family also used the cottage during the last 2 weeks of May (14 days). The cottage wasn't used at all before May 17 or after August 31.

You figure the part of the cottage expenses to treat as rental expenses as follows.

- The cottage was used for rental a total of 85 days (92 – 7). The days it was available for rent but not rented (7 days) aren't days of rental use. The July weekend (2 days) you used it is rental use because you received a fair rental price for the weekend.
- You used the cottage for personal purposes for 14 days (the last 2 weeks in May).
- The total use of the cottage was 99 days (14 days personal use + 85 days rental use).
- Your rental expenses are 85/99 (86%) of the cottage expenses.

Note: When determining whether you used the cottage as a home, the July weekend (2 days) you used it is considered personal use even though you received a fair rental price

for the weekend. Therefore, you had 16 days of personal use and 83 days of rental use for this purpose. Because you used the cottage for personal purposes more than 14 days and more than 10% of the days of rental use (8 days), you used it as a home. If you have a net loss, you may not be able to deduct all of the rental expenses. See *Dwelling Unit Used as a Home* next.

Dwelling Unit Used as a Home

If you use a dwelling unit for both rental and personal purposes, the tax treatment of the rental expenses you figured earlier under *Dividing Expenses* and rental income depends on whether you are considered to be using the dwelling unit as a home.

You use a dwelling unit as a home during the tax year if you use it for personal purposes more than the greater of:

1. 14 days, or

2. 10% of the total days it is rented to others at a fair rental price.

See What is a day of personal use, later.

If a dwelling unit is used for personal purposes on a day it is rented at a fair rental price (discussed earlier), don't count that day as a day of rental use in applying (2) above. Instead, count it as a day of personal use in applying both (1) and (2) above.

What is a day of personal use? A day of personal use of a dwelling unit is any day that the unit is used by any of the following persons.

1. You or any other person who owns an interest in it, unless you rent it to another owner as their main home under a shared equity financing agreement (defined later). However, see Days used as a main home before or after renting, later.

2. A member of your family or a member of the family of any other person who owns an interest in it, unless the family member uses the dwelling unit as their main home and pays a fair rental price. Family includes only your spouse, siblings, half siblings, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.).
3. Anyone under an arrangement that lets you use some other dwelling unit.
4. Anyone at less than a fair rental price.

Main home. If the other person or member of the family in (1) or (2) has more than one home, their main home is ordinarily the one they lived in most of the time.

Shared equity financing agreement. This is an agreement under which two or more persons acquire undivided interests for more than 50 years in an entire dwelling unit,

including the land, and one or more of the co-owners are entitled to occupy the unit as their main home upon payment of rent to the other co-owner(s).

Donation of use of the property. You use a dwelling unit for personal purposes if:

- You donate the use of the unit to a charitable organization,
- The organization sells the use of the unit at a fundraising event, and
- The “purchaser” uses the unit.

Examples. The following examples show how to determine if you have days of personal use.

Example 1. You and your neighbor are co-owners of a condominium at the beach. Last year, you rented the unit to vacationers whenever possible. The unit wasn’t used as a main home by anyone.