Instructions for Schedule E, Supplemental Income and Loss

Part I

Income or Loss from Rental Real Estate and Royalties

Use Part I to report:
- Income and expenses from rentals of real estate (including personal property leased with real estate), and
- Royalty income and expenses.

See the instructions for lines 3 and 4 to determine if you should report your rental real estate and royalty income on Schedule C, Schedule C-EZ, or Form 4835 instead.

If you own a part interest in a rental real estate property, report only your part of the income and expenses on Schedule E.

If you have more than three rental real estate or royalty properties, complete and attach as many Schedules E as you need to list them. Complete lines 1 and 2 for each property. But fill in the “Totals” column only on one Schedule E. The figures in the “Totals” column on that Schedule E should be the combined totals of all your Schedules E.

If you are also using page 2 of Schedule E, use the same Schedule E on which you entered the combined totals for Part I.

Personal Property. Do not use Schedule E to report income and expenses from the rental of personal property, such as equipment or vehicles. Instead, use Schedule C or C-EZ if you are in the business of renting personal property. You are in the business of renting personal property if the primary purpose for renting the property is income or profit, and you are involved in the rental activity with continuity and regularity.

If your rental of personal property is not a business, see the Instructions for Form 1040, lines 21 and 31, to find out how to report the income and expenses.

Filers of Form 1041

If you are a fiduciary filing Schedule E with Form 1041, enter the estate’s or trust’s employer identification number (EIN) in the block for “Your social security number.”

Line 1

For rental real estate property only, show:
- The kind of property you rented out (for example, brick duplex).
- The street address, city or town, and state. You do not have to give the ZIP code.
- Your percentage of ownership in this property, if less than 100%.

Line 2

If you rented out a dwelling unit that you also used for personal purposes during the year, you may not be able to deduct all the expenses for the rental part. “Dwelling unit” (unit) means a house, apartment, condominium, or similar property.

Check “Yes” if you or your family used the unit for personal purposes in 1997 more than the greater of:
1. 14 days; or
2. 10% of the total days it was rented to others at a fair rental price.

Otherwise, check “No.”

What Is Personal Use? A day of personal use is any day, or part of a day, that the unit was used by:
- You for personal purposes.
- Any other person for personal purposes, if that person owns or leases the unit (unless rented to that person under a “shared equity” financing agreement).
- Anyone in your family (or in the family of someone else who owns part of the unit), unless the unit is rented at a fair rental price to that person as his or her main home.
- Anyone who pays less than a fair rental price for the unit.
- Anyone under an agreement that lets you use some other unit.

Do not count as personal use:
- Any day you spent working substantially full time repairing and maintaining the unit, even if family members used it for recreational purposes on that day.
- The days you used the unit as your main home before or after renting it or offering it for rent, if you rented or tried to rent it for at least 12 consecutive months (or for a period of less than 12 consecutive months at the end of which you sold or exchanged it).

If you checked “No,” you can deduct all your expenses for the rental part, subject to the At-Risk Rules and the Passive Activity Loss Rules explained on page E-3.

If you checked “Yes” and rented the unit out for fewer than 15 days, do not report the rental income and do not deduct any rental expenses. If you itemize deductions on Schedule A, you may deduct allowable interest, taxes, and casualty losses.

If you checked “Yes” and rented the unit out for at least 15 days, you may NOT be able to deduct all your rental expenses. You can deduct all of the following expenses for the rental part on Schedule E:
- Mortgage interest.
- Real estate taxes.
- Casualty losses.
- Other rental expenses not related to your use of the unit as a home, such as advertising expenses and rental agents’ fees.

If any income is left after deducting these expenses, you can then deduct other expenses, including depreciation. But you cannot deduct more expenses than the income that is left. You can carry over the amounts you cannot deduct to 1998.

See Pub. 527 for more details.

Line 3

If you were not in the real estate sales business but you received rental income from real estate (including personal property leased with real estate), report it on line 3. Include room and other space rentals. If you received services or property instead of money as rent, report its fair market value.

Be sure to enter your total rents in the “Totals” column even if you have only one property.

If you provided significant services to the renter, such as maid service, report the rental on Schedule C or C-EZ, not on Schedule E. Significant services do not include the furnishing of heat and light, cleaning of public areas, trash collection, etc.

If you were in the real estate sales business, include on line 3 only the rent received from real estate (including per-
sional property leased with real estate) you held for investment or speculation. Do not use Schedule E to report income and expenses from rentals of real estate held for sale to customers in the ordinary course of your real estate sales business. Instead, use Schedule C or C-EZ for these rentals.

For more details on rental income, use TeleTax topic 414 (see page 34 of the Form 1040 instructions) or see Pub. 527.

**Rental Income From Farm Production or Crop Shares.** Report farm rental income and expenses on Form 4835 if:

- You received rental income based on crops or livestock produced by the tenant, and
- You did not manage or operate the farm to any great extent.

**Line 4**

Report on line 4 royalties from oil, gas, or mineral properties (not including operating interests); copyrights; and patents. Enter your total royalties in the “Totals” column.

If you received $10 or more in royalties during 1997, you should receive a Form 1099-MISC or similar statement, showing them. The payer must send this statement to you by February 2, 1998.

If you are in business as a self-employed writer, inventor, artist, etc., report your royalty income and expenses on Schedule C or C-EZ.

You may be able to treat amounts received as “royalties” for transfer of a patent or amounts received on the disposal of coal and iron ore as the sale of a capital asset. For details, see Pub. 544.

Enter on line 4 the gross amount of royalty income, even if state or local taxes were withheld from oil or gas payments you received. Include taxes withheld by the producer on line 16.

**General Instructions for Lines 5 Through 21**

Enter your rental and royalty expenses for each property in the appropriate column. You can deduct all ordinary and necessary expenses, such as taxes, interest, repairs, insurance, management fees, agents’ commissions, and depreciation.

Do not deduct the value of your own labor or amounts paid for capital investments or capital improvements.

Enter your total expenses for mortgage interest (line 12), total expenses before depreciation expense or depletion (line 19), and depreciation expenses or depletion (line 20) in the “Totals” column even if you have only one property.

**Renting Out Part of Your Home.** If you rent out only part of your home or other property, deduct the part of your expenses that applies to the rented part.

**Credit or Deduction for Access Expenditures.** You may be able to claim a tax credit for eligible expenditures paid or incurred in 1997 to provide access to your business for individuals with disabilities. See Form 8826 for details.

You can also deduct up to $15,000 of qualified costs paid or incurred in 1997 to remove architectural or transportation barriers to individuals with disabilities and the elderly.

You cannot take both the credit and the deduction for the same expenditures. See Pub. 535 for details.

**Line 6**

You may deduct ordinary and necessary auto and travel expenses related to your rental activities, including 50% of meal expenses incurred while traveling away from home. If you own your auto, you can deduct either your actual expenses or take the standard mileage rate. You must use actual expenses if:

- You do not own the auto you use in your rental activities, or
- You use more than one vehicle simultaneously in your rental activities (as in fleet operations).

If you deduct actual auto expenses, include on line 6 the rental activity portion of the cost of gasoline, oil, repairs, insurance, tires, etc. Show auto rental or lease payments on line 18 and depreciation on line 20.

If you want to take the standard mileage rate, multiply the number of miles you drove your auto in connection with your rental activities by 31.5 cents a mile. Include this amount and your parking fees and tolls on line 6.

If you claim any auto expenses (actual or the standard mileage rate), you must provide the information requested in Part V of Form 4562 and attach Form 4562 to your return.

See Pub. 527 and Pub. 463 for more details.

**Line 10**

Include on line 10 fees for tax advice related to your rental real estate or royalty properties and for preparation of the tax forms related to those properties.

Do not deduct legal fees paid or incurred to defend or protect title to property, to recover property, or to develop or improve property. Instead, you must capitalize these fees and add them to the property’s basis.

**Lines 12 and 13**

In general, to determine the interest expense allocable to your rental activities, you must have records to show how the proceeds of each debt were used. Specific tracing rules apply for allocating debt proceeds and repayment. See Pub. 535 for further details.

If you have a mortgage on your rental property, enter on line 12 the interest you paid for 1997 to banks or other financial institutions. Be sure to fill in the “Totals” column.
You are claiming depreciation on listed property (defined in the Instructions for Form 4562), including a vehicle, regardless of the date it was placed in service, or

You are claiming a section 179 expense deduction or amortization of costs that began in 1997.

See Pub. 527 for more information on depreciation of residential rental property. See Pub. 946 for a more comprehensive guide to depreciation.

If you own mineral property or an oil, gas, or geothermal well, you may be able to take a deduction for depletion. See Pub. 535 for details.

**Line 22**

**At-Risk Rules**

Generally, you must complete Form 6198 to figure your allowable loss if you have:

- A loss from an activity carried on as a trade or business or for the production of income, and
- Amounts in the activity for which you are not at risk.

The at-risk rules generally limit the amount of loss (including loss on the disposition of assets) you can claim to the amount you could actually lose in the activity. However, the at-risk rules do not apply to losses from an activity of holding real property, if you acquired your interest in the activity before 1987 and the property was already in service before 1987. The activity of holding mineral property does not qualify for this exception.

In most cases, you are not at risk for amounts such as:

- Nonrecourse loans used to finance the activity, to acquire property used in the activity, or to acquire your interest in the activity that are not secured by your own property (other than property used in the activity). However, there is an exception for certain nonrecourse financing borrowed to hold real property. See **Qualified nonrecourse financing** below.

- Cash, property, or borrowed amounts used in the activity (or contributed to the activity, or used to acquire your interest in the activity) that are protected against loss by a guarantee, stop-loss agreement, or other similar arrangement (excluding casualty insurance and insurance against tort liability).

- Amounts borrowed for use in the activity from a person who has an interest in the activity (other than as a creditor) or who is related, under Internal Revenue Code section 465(b)(3), to a person (other than you) having such an interest.

**Qualified nonrecourse financing** is treated as an amount at risk if it is secured by real property used in an activity of holding real property that is subject to the at-risk rules. Qualified nonrecourse financing is financing for which no one is personally liable for repayment and is:

- Borrowed by you in connection with holding real property,
- Not convertible from a debt obligation to an ownership interest, and
- Loaned or guaranteed by any Federal, state, or local government, or borrowed by you from a **qualified person**.

A qualified person is a person who actively and regularly engages in the business of lending money, such as a bank or savings and loan association. A qualified person cannot be:

- Related to you (unless the nonrecourse financing obtained is commercially reasonable and on the same terms as loans involving unrelated persons), or
- The seller of the property (or a person related to the seller), or
- A person who receives a fee due to your investment in real property (or a person related to that person).

If you have amounts for which you are not at risk, use Form 6198 to determine the amount of your deductible loss. Enter that amount in the appropriate column of Schedule E, line 22. In the space to the left of line 22, write "Form 6198." Attach Form 6198 to your return.

**Line 23**

**Note:** Do not complete line 23 if the amount on line 22 is from royalty properties.

If you have a rental real estate loss from a passive activity (defined later), the amount of loss you can deduct may be limited by the passive activity loss rules. You may need to complete Form 8582 to figure the amount of loss, if any, to enter on line 23.

If your rental real estate loss is not from a passive activity OR you meet the following exceptions, you do not have to complete Form 8582. Enter the loss from line 22 on line 23.

**Exception for Certain Rental Real Estate Activities.** If you meet ALL THREE of the following conditions, your rental real estate losses are not limited by the passive activity loss rules. If you **do not** meet ALL THREE of these conditions, see the Instructions for Form 8582 to find out if you must complete and attach Form 8582.

1. Rental real estate activities are your only passive activities.
2. You do not have any prior year unallowed losses from any passive activities.
3. All of the following apply if you have an overall net loss from these activities:
   - You actively participated (defined later) in all of the rental real estate activities; and
   - If married filing separately, you lived apart from your spouse all year; and
   - Your overall net loss from these activities is $25,000 or less ($12,500 or less if married filing separately); and
   - You have no current or prior year unallowed credits from passive activities; and
   - Your modified adjusted gross income (defined later) is $100,000 or less ($50,000 or less if married filing separately).

**Active Participation.** You can meet the active participation requirement without regular, continuous, and substantial involvement in real estate activities. But you must have participated in making management decisions or arranging for others to provide services (such as repairs) in a significant and bona fide sense. Such management decisions include:

- Approving new tenants.
- Deciding on rental terms.
- Approving capital or repair expenditures.
- Other similar decisions.

You are not considered to actively participate if, at any time during the tax year, your interest (including your spouse’s interest) in the activity was less than 10% by value of all interests in the activity.

**Modified Adjusted Gross Income.** This is your adjusted gross income from Form 1040, line 32, without taking into account:

- Any passive activity loss.
- Rental real estate losses allowed under the exception for real estate professionals (explained on page E-4).
- Taxable social security or equivalent railroad retirement benefits.
- Deductible contributions to an IRA or certain other qualified retirement plans under Internal Revenue Code section 219.
- The deduction for one-half of self-employment tax.
- The exclusion of amounts received under an employer's adoption assistance program.

However, if you file Form 8815, include in your modified adjusted gross income the savings bond interest excluded on line 14 of that form.

**Passive Activity Loss Rules**

The passive activity loss rules may limit the amount of losses you can deduct. These rules apply to losses in Parts I, II, and III, and line 39 of Schedule E.

Losses from passive activities may be subject first to the at-risk rules. Losses deductible under the at-risk rules are then subject to the passive activity loss rules.

You generally can deduct losses from passive activities only to the extent of income from passive activities. An exception applies to certain rental real estate activities (as previously explained).

**Passive Activity.** A passive activity is any business activity in which you **do not** materially participate and any rental activity, except as provided on page E-4. If you are a limited partner, you generally are not treated as having materially participated in the partnership’s activities for the year.

The rental of real or personal property is generally a rental activity under the passive activity loss rules, but exceptions apply. If your rental of property is not treated as a rental activity, you must determine...
whether it is a trade or business activity, and if so, whether you materially participated in the activity for the tax year.

See the Instructions for Form 8582 to determine whether you materially participated in the activity and for the definition of “rental activity.”

See Pub. 925 for special rules that apply to rentals of:
- Substantially nondepreciable property
- Property incidental to development activities
- Property to activities in which you materially participate.

Exception for Real Estate Professionals. If you were a real estate professional in 1997, any rental real estate activity in which you materially participated is not a passive activity. You were a real estate professional only if you met both of the following conditions.

1. More than half of the personal services you performed in trades or businesses were performed in real property trades or businesses in which you materially participated.

2. You performed more than 750 hours of services in real property trades or businesses in which you materially participated.

For purposes of this rule, 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. To make this election, attach a statement to your original tax return that declares you are a qualifying taxpayer for the year and you are making the election under Internal Revenue Code section 469(c)(7)(A). The election applies for the year made and all later years in which you are a real estate professional. You may revoke the election only if your facts and circumstances materially change.

If you are married filing jointly, either you or your spouse must separately meet both of the above conditions, without taking into account services performed by the other spouse.

A real property trade or business is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. Services you performed as an employee are not treated as performed in a real property trade or business unless you owned more than 5% of the stock (or more than 5% of the capital or profits interest) in the employer.

If you were a real estate professional for 1997, complete line 42 on page 2 of Schedule E.

Other Exceptions. The rental of your home that you also used for personal purposes is not a passive activity. See the instructions for line 2.

A working interest in an oil or gas well that you hold directly through an entity that does not limit your liability is not a passive activity even if you do not materially participate.

Royalty income not derived in the ordinary course of a trade or business reported on Schedule E generally is not considered income from a passive activity.

For more details on passive activities, see the Instructions for Form 8582 and Pub. 925.

Parts II and III

If you need more space in Part II or III to list your income or losses, attach a continuation sheet using the same format as shown in Part II or III. However, be sure to complete the “Totals” columns for lines 28a and 28b, or lines 33a and 33b, as appropriate. If you also completed Part I on more than one Schedule E, use the same Schedule E on which you entered the combined totals in Part I.

Tax Shelter Registration Number. Complete and attach Form 8271 if you are reporting any deduction, loss, credit, other tax benefit, or income from an interest purchased or otherwise acquired in a tax shelter.

Form 8271 reports the name, tax shelter registration number, and identifying number of the tax shelter. There is a $250 penalty if you do not report the registration number of the tax shelter on your tax return.

Tax Preference Items. If you are a partner, a shareholder in an S corporation, or a beneficiary of an estate or trust, you must take into account your share of preferences and adjustments from these entities for the alternative minimum tax on Form 6251 or Schedule I of Form 1041.

Part II

Income or Loss From Partnerships and S Corporations

If you are a member of a partnership or joint venture or a shareholder in an S corporation, use Part II to report your share of the partnership or S corporation income (even if not received) or loss.

You should receive a Schedule K-1 from the partnership or the S corporation. You should also receive a copy of the Partner’s or Shareholder’s Instructions for Schedule K-1. Your copy of Schedule K-1 and its instructions will tell you where on your return to report your share of the items. If you did not receive these instructions with your Schedule K-1, see page 4 of the Form 1040 instructions for how to get a copy.

Do not attach Schedules K-1 to your return. Keep them for your records.

Special rules apply that limit losses. Please note the following:
- If you have a current year loss, or a prior year unallowable loss, from a partner-
amounts are now deductible, do not combine the prior year amounts with any current year amounts to arrive at a net figure to report on Schedule E. Instead, report the prior year amounts and the current year amounts on separate lines of Schedule E.

Part or all of your share of partnership income or loss from the operation of the business may be considered net earnings from self-employment that must be reported on Schedule SE. Enter the amount from Schedule K-1 (Form 1065), line 15a, on Schedule SE, after you reduce this amount by any allowable expenses attributable to that income.

**S Corporations**

If you are a shareholder in an S corporation, your share of the corporation’s aggregate losses and deductions (combined income, losses, and deductions) is limited to the adjusted basis of your corporate stock and any debt the corporation owes you. Any loss or deduction not allowed this year because of the basis limitation may be carried forward and deducted in a later year subject to the basis limitation for that year.

If you are claiming a deduction for your share of an aggregate loss, attach to your return a computation of the adjusted basis of your corporate stock and of any debt the corporation owes you. See the Schedule K-1 instructions for more information.

After applying the basis limitation, the deductible amount of your aggregate losses and deductions may be further reduced by the at-risk rules and the passive activity loss rules explained earlier.

If you have losses or deductions from a prior year that you could not deduct because of the basis or at-risk limitations, and the amounts are now deductible, do not combine the prior year amounts with any current year amounts to arrive at a net figure to report on Schedule E. Instead, report the prior year amounts and the current year amounts on separate lines of Schedule E.

Distributions of prior year accumulated earnings and profits of S corporations are dividends and are reported on Form 1040, line 9.

Interest expense relating to the acquisition of shares in an S corporation may be fully deductible on Schedule E. Instead, enter the amount on Form 1040, line 55.

A U.S. person who transferred property to a foreign trust may have to report the income received by the trust as a result of the transferred property if, during 1997, the trust had a U.S. beneficiary. For details, see Form 3520.

**Part IV**

**Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)**

If you are the holder of a residual interest in a real estate mortgage investment conduit (REMIC), use Part IV to report your total share of the REMIC’s taxable income or loss for each quarter included in your tax year. You should receive Schedule Q (Form 1066) and instructions from the REMIC for each quarter.

Do not attach Schedules Q to your return. Keep them for your records.

If you are the holder of a residual interest in more than one REMIC, attach a continuation sheet using the same format as in Part IV. Enter the totals of columns (d) and (e) on line 38 of Schedule E. If you also completed Part I on more than one Schedule E, use the same Schedule E on which you entered the combined totals in Part I.

REMIC income or loss is not income or loss from a passive activity.

**Note:** If you are the holder of a regular interest in a REMIC, do not use Schedule E to report the income you received. Instead, report it on Form 1040, line 8a.

**Column (c).** Report the total of the amounts shown on Schedule(s) Q, line 2c. This is the smallest amount you are allowed to report as your taxable income (Form 1040, line 38). It is also the smallest amount you are allowed to report as your alternative minimum taxable income (AMTI) (Form 6251, line 21).

If the amount in column (c) is larger than your taxable income would otherwise be, enter the amount from column (c) on Form 1040, line 38. Similarly, if the amount in column (c) is larger than your AMTI would otherwise be, enter the amount from column (c) on Form 6251, line 21. Write “Sch. Q” on the dotted line to the left of this amount on Forms 1040 and 6251.

**Note:** These rules also apply to estates and trusts that hold a residual interest in a REMIC. Be sure to make the appropriate entries on the comparable lines on Form 1041.