

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

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from: Charles Ramsey, Branch Chief  
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subject: Residential Rental Property Definition

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ISSUE

Whether the portion of a taxpayer's apartment used by the taxpayer for a home office should be depreciated as residential rental property or nonresidential real property, if the taxpayer owns the apartment building in which the apartment is located and 80 percent or more of the gross rental income from the building is from dwelling units?

CONCLUSION

To the extent the taxpayer is entitled to depreciation for the home office portion of the apartment unit, the taxpayer should calculate depreciation based on treating the unit as residential rental property and using a 27.5 year recovery period (or a 40 year recovery period if the alternative depreciation system of § 168(g) of the Internal Revenue Code applies).

FACTS

The taxpayer owns an apartment building containing eight essentially identical apartment units. The taxpayer lives in one of the apartments and leases the other seven to tenants who use the apartment units as "dwelling units," as that term is defined by

§ 168(e)(2)(A)(ii). The apartment unit that taxpayer occupies is 1,200 square feet. The taxpayer exclusively uses 200 square feet of the apartment for a home office for a single trade or business, which may, or may not, be the rental of residential property. The taxpayer satisfies the requirements of § 280A for deduction of the expenses of a home office including expenses for depreciation.

### LAW AND ANALYSIS

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business or held for the production of income. The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168.

Section 168(c) provides that for purposes of the general depreciation system of § 168(a), (1) in the case residential rental property, the applicable recovery period is 27.5 years, and (2) in the case of nonresidential real property, the applicable recovery period is 39 years. Section 168(c)(2)(B) provides that the term nonresidential real property means § 1250 property that is neither residential rental property or property with a class life of less 27.5 years.

Section 168(e)(2)(A)(i) provides that for purposes of § 168, the term “residential rental property” means any building or structure if 80 percent or more of the gross rental income from such building or structure for the taxable year is rental income from dwelling units. Section 168(e)(2)(A)(ii)(II) provides that if any portion of the building or structure is occupied by the taxpayer, the gross rental income from such building or structure shall include the rental value of the portion so occupied.

Section 168(e)(2)(A)(ii)(I) provides that the term “dwelling unit” generally means a house or apartment used to provide living accommodations in a building or structure. Section 1.48-1(e)(1) of the Income Tax Regulations defines the term “building” generally to mean any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, among other examples, an apartment house.

Section 3.02(2) of Rev. Proc. 87-57, 1987-2 C.B. 687, 689, provides that property is residential rental property under § 168(e)(2) only if the property is described in former § 167(j)(2)(B). Former § 1.167(j)-3(b)(1) of the regulations under former § 167(j) provides that subject to certain additional limitations, “residential rental property” means a building or structure used to provide living accommodations **on a rental basis** (emphasis added).

Rev. Proc. 87-57 provides that a building or structure is residential rental property for any taxable year only if 80 percent or more of the gross rental income from the building

or structure is rental income from dwelling units. Rev. Proc. 87-57 also provides that, if any portion of the building or structure is occupied by the taxpayer as a residence, the gross rental income from the building or structure includes the rental value of the portion so occupied. The examples of former § 1.167(j)-3(b)(6) of the regulations show that if a building or structure is used to provide living accommodations on a rental basis and if any portion of that building or structure is occupied by the taxpayer, the fair rental value of the portion occupied by the taxpayer as a residence is treated as gross rental income from the building and as rental income from dwelling units and that the fair rental value of the portion occupied by the taxpayer for a commercial activity (such as operating a store) is treated as gross rental income from the building but not as rental income from dwelling units.

Former § 1.167(j)-3(b)(3) of the regulations provides that gross rental income from a building is gross rental income from a dwelling unit in such building only if the rental income is attributable to or ordinarily associated with the use of, or the right to use, the unit as a living accommodation. If a portion of the building is used for a drugstore, grocery store, commercial laundry, or other commercial operation, the rent paid for such portion (including any amount paid for services in connection with such a commercial operation) is not rental income from a dwelling unit. Similarly, if pursuant to the terms of a lease or other agreement, a portion of a house or apartment is used as office space, such as a doctor's office, the rent paid with respect to such portion is gross rental income from the building but is not rental income from a dwelling unit.

Section 280A(a) provides that generally no deduction is allow to a taxpayer with respect to the use of a dwelling unit that is used by the taxpayer during the taxable year as a residence. Section 280A(f)(1)(A) generally defines a "dwelling unit," for purposes of § 280A, to include a house, apartment, condominium, mobile home, boat, or similar property unit.

Section 280A(c) provides exceptions to § 280A(a). Section 280A(c)(1)(A) provides that § 280A(a) does not apply to any item to the extent such item is allocable to a portion of a dwelling unit that is exclusively used on a regular basis as the principal place of business for any trade or business of the taxpayer. Section 280(c)(3) provides that § 280A(a) does not apply to any item that is attributable to the rental of a dwelling unit or portion of the unit. However, § 280A(c)(5) limits deductions in the case of either rental use or home office use if the unit is used as a residence.

Section 168(e)(2) defines property as residential rental property by reference to a "building or structure," not to a dwelling unit or portion of a dwelling unit. For a building to be residential rental property it must contain at least one dwelling unit that is actually rented to provide living accommodations. If the building satisfies this threshold test, then the 80 percent of gross rental income test is applied. Under the facts of this case, the taxpayer owns the entire apartment building. Of the eight apartment units in this building, the taxpayer leases seven units to tenants who use them as dwelling units and occupies one unit. A portion of the apartment unit occupied by the taxpayer is

exclusively used as a home office (200 square feet) and the remainder of that unit is used as a personal residence (1,000 square feet). Even though the rental value of the 200 square feet of the apartment unit used by the taxpayer for a home office is not treated as rental income from a dwelling unit, the entire building satisfies the “80 percent” test for treating the building as residential rental property. Section 280A does not require a taxpayer to carve out a “nonresidential real property” portion from a building that is residential rental property under § 168(e)(2). Thus, in this case, to the extent the taxpayer is entitled to depreciation for the home office portion of the apartment unit, the taxpayer should calculate depreciation based on treating the unit as residential rental property and using a 27.5 year recovery period (or a 40 year recovery period if the alternative depreciation system of § 168(g) applies).

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Our publications provide that a taxpayer should depreciate that part of the taxpayer’s home used for a home office over a 39-year recovery period. See 2004 Publication 946, *How to Depreciate Property*, at 33, and 2004 Publication 587, *Business Use of Your Home*, at 10. In the case of a taxpayer who uses a portion of his or her personal-use single-family residence for a home office, the residence is not residential rental property because the residence is not used to provide living accommodations on a rental basis. If the only rental income from dwelling units in a building is deemed rental income that results from the taxpayer’s occupancy of the building as a residence, the building is not used to provide living accommodations on a rental basis. For a building to be residential rental property it must contain at least one dwelling unit that is actually rented to provide living accommodations; if the building satisfies this threshold requirement, the 80 percent of gross rental income test is then applied. A personal use single-family residence is nonresidential real property if it is § 1250 property and is neither residential rental property nor property with a class life of less than 27.5 years. Thus, the result reached in the publications is correct in the case of a home office in a typical single-family residence.

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Please call Charles Magee at (202) 622-3110 if you have any further questions.

(signed) Charles Ramsey  
Charles Ramsey