Airbnb

General guidance on the taxation of rental income

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Please refer to the Airbnb Responsible Hosting Page at https://www.airbnb.com/help/responsible-hosting for additional general information about hosting in the United States.

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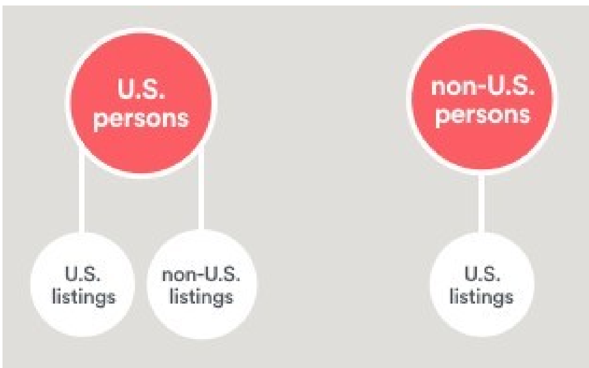
1. Persons subject to US income tax

I am an Airbnb host. Am I subject to income tax in the U.S.?

You are subject to U.S. income tax if you have U.S.-source income. Generally, income derived from U.S. assets, such as rental properties located in the U.S., is U.S. -source income and subject to U.S. income tax.



Domestic rental income (i.e. rental income from a property located inside the U.S.) is taxable in the U.S. regardless of where the person in receipt of that income resides. For example, an individual living outside the U.S. who is in receipt of rental income from a U.S. property is still subject to tax in the United States.

Foreign rental income (i.e. rental income from a property located outside the U.S.) is taxable in the U.S. if the host is a U.S. citizen or permanent resident. An individual in receipt of foreign rental income should engage a tax advisor to ensure that rental income is correctly reported and any tax due is paid timely.

Types of taxpayers: cash-basis vs. accrual basis

If you are subject to U.S. income tax, you must report your rental income as a cash-basis or accrual-basis taxpayer.

If you are a cash-basis taxpayer, you report rental income on your return for the year you actually or constructively receive it and you deduct all expenses in the year you actually pay them. You are a cash-basis taxpayer if you report income in the year you receive it, regardless of when it is earned. Most individuals are cash-basis taxpayers. You constructively receive income when it is made available to you, for example, by being credited to your bank account.

If you are an accrual-basis taxpayer, you generally report income when you earn it instead of when you receive it and you deduct expenses when you incur them instead of when you pay them. Accrual-basis taxpayers should engage a tax advisor to ensure that rental income and expenses are correctly reported.

2. Rental income

If you are subject to U.S. income taxes, you must include in your gross income all amounts you receive as rent. 'Rent' is the gross amount of payment received (before any expenses are deducted) for the use or occupation of property. It can also include payments received for any goods or services that are provided, e.g. meals, cleaning, etc.

Taxable rental income is the gross amount of rent received less any allowable expenses. This can also be referred to as 'net' rental income. If the allowable expenses are greater than the gross amount of rent received, a rental loss will arise. Taxable rental income/(loss) must be reported and calculated on Schedule C or E of Form 1040 (see section 9 "How to report rental income and expenses").

In addition to the amounts you receive as normal rent payments, you may also receive other amounts that should be carefully considered in determining the amount of gross rental income to report. Examples of such amounts include:

- **Advance rent** is any rent you receive before the period that it covers. Include advance rent in your rental income in the year you receive it regardless of the period covered or if you are a cash or accrual basis taxpayer. For example, if you receive rent in December 2016 that is intended for January 2017, you must include it in rental income in 2016.

- **Security deposits** are not included in rental income if you have restricted use of the money. For example, if you have to return security deposit to guests at the end of their stay, it is not included in rental income. If you keep part or all of the security deposit because a Guest damaged the property and you must make repairs, include the amount you keep in that year in rental income if you deduct the cost of repairs as expenses. To the extent the security deposit reimburses those expenses, do not include the amount in rental income if you do not deduct the cost of repairs as expenses.

- If a Guest pays any of your expenses, for example, utilities expenses, the payments are rental income. Since you must include this amount in income, you can deduct the expenses if they are deductible rental expenses (defined in *section 4 "Expense that can be deducted"*).

- If a Guest cancels a reservation and you receive a portion of the accommodation fee, the amount you receive is rent. Include the payment in your income in the year you receive it.

- Any rent refunded to a Guest due to cancellation is not included as net rental income. Tax documents, such as 1099-K, are reported on a gross basis. Any gross rent that is refunded should be included as gross rental income and also taken as a deduction.

Example: You receive a payout of $5,000 for a Guest's 10-day stay. The Guest only stays for 8 days and you offer a $1,000 refund via Airbnb. A $1,000 "adjustment" is placed on your account and automatically deducted from your next scheduled payout of $5,000 for another Guest's stay. Your total payout is $9,000 ($5,000 - $1,000 + $5,000). Your gross rental income is $10,000 and reported as such on your 1099-K or Earnings Summary. On your tax return, you report $10,000 as gross rent and $1,000 as a deduction to arrive to net rental income of $9,000.

Exemptions:

If you use a dwelling unit as a home and you rent it less than 15 days during the year, its primary function is not considered to be rental. You are not required to report the rental income and rental expenses from this activity on Schedule C or E (Form 1040). The expenses, including qualified mortgage interest, property taxes, and any qualified casualty loss will be reported as normally allowed on Schedule A (Form 1040). See the Instructions for Schedule A (Form 1040) for more information on deducting these expenses.

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 does not 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 is not used by an owner as a home during the year.

3. What tax information will Airbnb provide

An Airbnb host can refer to this Airbnb Help Center article at https://www.airbnb.com/help/article/414/what-tax-forms-should-i-expect-to-receive-from-airbnb?topic=248 as a guide to determining what tax forms Airbnb may provide to assist with reporting gross rental income for any calendar year.

4. Expenses that can be deducted

As outlined above, taxable rental income is the gross amount of rent received less any allowable expenses. In general, a deductible or allowable expense is one that is ordinary and necessary, has actually been paid (for a cash basis taxpayer) and is not regarded as capital in nature. Examples of deductible expenses include:

- Advertising
- Cleaning and maintenance services, including laundry services and cleaning supplies purchased
- Utilities, i.e. gas, electricity, TV, Internet, bin collection, etc.
- Property insurance, in addition to building and content cover, a deduction can also be claimed for private mortgage insurance (PMI) premiums on rental property. However, if you prepay PMI premiums for more than one year in advance, for each year of coverage you can deduct only part of the PMI payment that will apply to that year
- Property taxes related to the rental property
- Interest on a loan/mortgage taken out to buy or improve the rental property
- Fees paid to collect rent, e.g. service fees charged by Airbnb
- Ordinary and necessary travel and transportation
- Repairs, i.e. fixing broken windows, doors, furniture and machines, etc. *(See section 6 "Repairs & maintenance vs. improvements – deduct or capitalize")*
- Depreciation on amounts paid to acquire the property and to make subsequent improvements *(See section 6 "Repairs & maintenance vs. improvements – deduct or capitalize" & section 7 "Depreciation")*

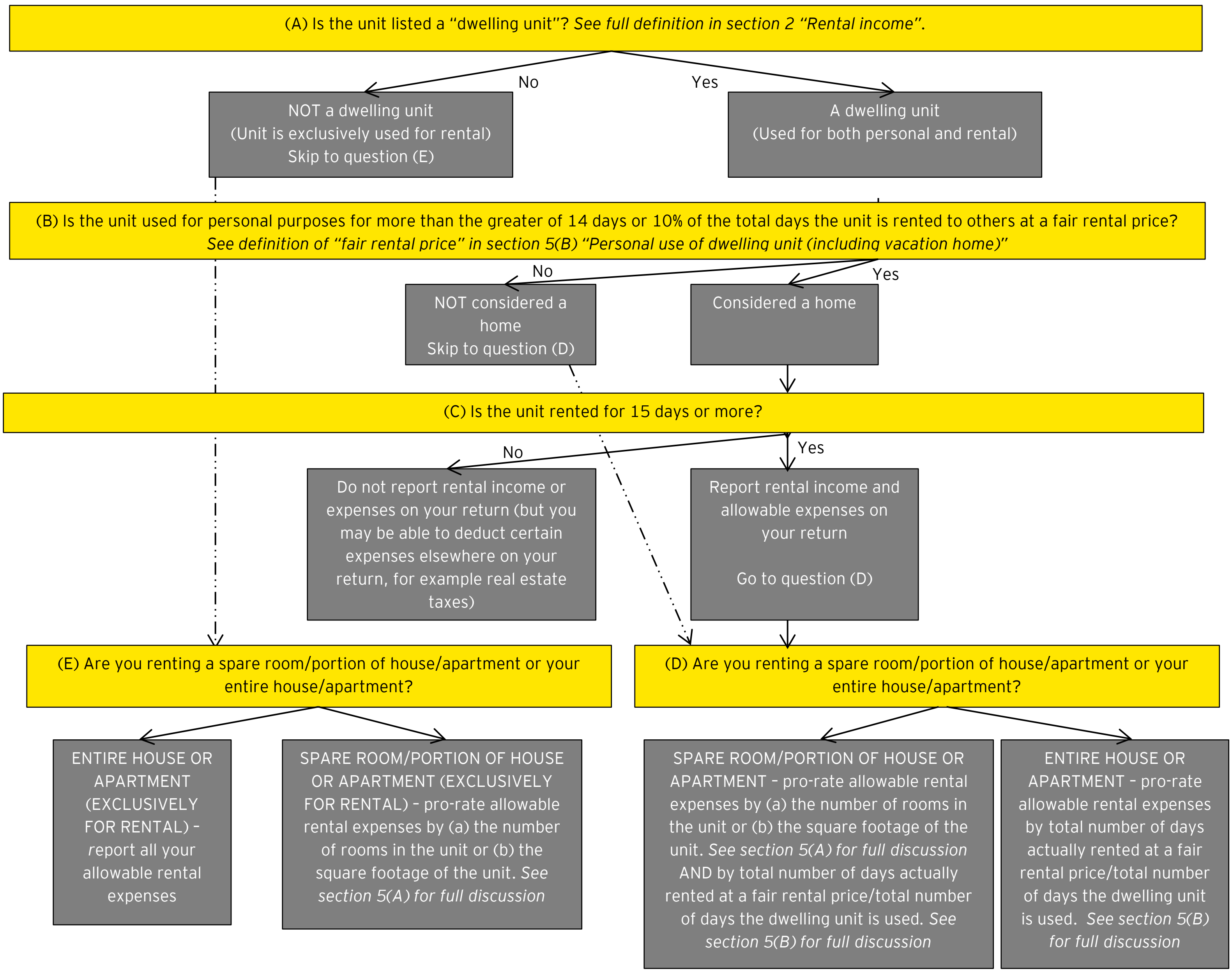
- Amortization of points paid to acquire a mortgage on the rental property
- The cost of managing the property, i.e. legal fees and accountancy fees incurred by the host in connection with renting the property. Homeowners' association (HOA) fees are also deductible
- Payments made to Guest in the form of refunds (in the event of a reservation cancellation or alteration, or through Airbnb's Resolution Center).
- Registration fees for relevant conferences or education on property management (i.e. Airbnb Open)
- Rental payments, e.g. rent paid to landlords by tenant hosts

This list is not exhaustive. Please refer to IRS Publication 527 "Residential Rental Property" for a more detailed discussion on deductible rental expenses.

Example of deductible travel expenses: You are a US host with a listing in Florida. If you take a 1-week trip to Florida and spend 1 day inspecting your rental property, no non-local transportation expenses are deductible. If, on the other hand, 6 of the 7 days are used to repair and attend to the property, all non-local transportation expenses are deductible. In both cases, local transportation expenses incurred traveling to and from the property are deductible. However, if a stretch limousine is rented for the local travel, more than likely the IRS would not consider the expense an "ordinary" expense. Any deduction allowed would be limited to the amount that would be considered "ordinary," such as the cost of a rental car or cab fare.

5. Proration of rental expenses

Generally, only allowable expenses incurred during the period the property is used or held out for rental purposes can be deducted against rental income. If you use or hold out the property for rental purposes for the entire year, all your allowable rental expenses are deductible. For Hosts, however, there may be scenarios where only a portion of the house or apartment is rented and/or the house or apartment is rented for only a portion of the year. Proration of allowable rental expenses becomes necessary in these scenarios. The following decision tree helps you determine when and how to prorate your rental expenses in various scenarios. A more detailed discussion related to proration of rental expenses follows.



I. Renting part of the 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. You can also deduct as rental expenses a portion of other expenses that normally are nondeductible personal expenses, such as utilities. The two most common methods for dividing an expense are based on (1) the number of rooms in your home, and (2) the square footage of your home

You do not have to pro-rate any expenses that are exclusively related to the rental part of your property. For example, if you paint a room that you rent, the entire cost is a rental expense.

Even though you cannot deduct the portion of allowable expenses for personal purposes against rental income, certain personal expenses, such as home mortgage interest and real estate taxes, can be deducted on Schedule A if you itemize your deduction *(see section 10 "How to report deductible personal expenses")*.

Example: You list your spare room in your house. The spare room is 200 square feet and the rest of the house is 800 square feet. You incur the following expenses:

Repainting the spare room - $500
Replacing broken window in the spare room - $500
Property tax and mortgage interest - $5,000
Internet, electricity and water - $1,000

Expenses for painting the spare room and replacing broken window in the spare room are exclusively related to the rental part of your house and hence these expenses are fully deductible rental expenses.

Expenses for property tax, mortgage interest, internet, electricity and water are not exclusively for the rental part of your house, but for the entire house. You have to pro-rate these expenses based on a reasonable method. If you pro-rate your expenses based on the square footage of the house, the fraction of expenses for rental purposes is 20% (200/1,000 sq. ft.) The amount of deductible rental expense is $1,200 ($6,000 * 20%). Property tax and mortgage interest of $4,000 [$5,000 * (1-20%)] can be deducted on Schedule A if you itemize your deduction. Internet, electricity and water expenses of $800 [$1,000 * (1-20%)] are considered personal expenses and not deductible.

II. 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 out, 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 the following fraction:

$$\frac{\text{total number of days actually rented at a fair rental price}}{\text{total number of days the dwelling unit is used}}$$

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. If you used the dwelling unit as a home and you rented it for less than 15 days during the year, any income generated is excluded from rental income and any rental expenses are not deductible.

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 does not apply when determining whether you used the unit as a home.
- Any day that the unit is available for rent but not actually rented is not a day of rental use.

Example: Your beach cottage was available for rent from June 1 through August 31 (92 days). During that time, 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. 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 was not 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 less 7). The days it was available for rent but not rented (7 days) are not 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.

If you use a dwelling unit for both rental and personal purposes, the tax treatment of the rental expenses you figured earlier 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:

- 14 days, or
- 10% of the total days it is rented to others at a fair rental price.

Fair rental price. A fair rental price for your property generally is the amount of rent that a person who is not related to you would be willing to pay. The rent you charge is not 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.

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

- You or any other person who has an interest in the unit, unless you rent it to another owner as his or her main home.
- A member of your family or a member of the family of any other person who owns an interest in the unit, unless the family member uses the dwelling unit as his or her main home and pays a fair rental price. Family includes only your spouse, brothers and sisters, half-brothers and half-sisters, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.).
- Anyone under an arrangement that lets you use some other dwelling unit.
- Anyone at less than a fair rental price.

If you do use a dwelling unit for personal purposes, then how you report your rental income and expenses depends on whether you used the dwelling unit as a home.

If you use a dwelling unit for personal purposes, but not as a home, report all the rental income in your income. Since you used the dwelling unit for personal purposes, you must divide your expenses between the rental use and the personal use as described earlier. The expenses for personal use are not deductible as rental expenses.

If you use a dwelling unit as a home and you rent it less than 15 days during the year, its primary function is not considered to be rental and you are not required to report the rental income and rental expenses from this activity.

If you use a dwelling unit as a home and rent it 15 days or more during the year, include all your rental income in your income. Since you used the dwelling unit for personal purposes, you must divide your expenses between the rental use and the personal use as described earlier. The expenses for personal use are not deductible as rental expenses.

You may deduct expenses on your rental property during a period in which it is not being rented as long as it is actively being held out for rent. This applies to a period between rentals, as well as to the period during which a property is being marketed as a rental property for the first time. The IRS can disallow these deductions if you are unable to show you were actively seeking a profit and had a reasonable expectation of achieving one. The deduction cannot be disallowed just because your property is difficult to rent.

If you own a part interest in rental property, you can deduct expense that you paid according to your percentage of ownership.

More Sample Net Rental Income (Expenses) Computations:

Example: A married couple lists their entire house on Airbnb for the entire year. Rent is $2,000 per month. Property tax and mortgage interest are $5,000 for the year. Utilities expenses for the year come out to be $5,000.

Since the house is solely used for rental purposes, all rental expenses are deductible. Their net rental income is $14,000 ($2,000*12-$5,000-$5,000).

Example: A host lists his spare room in his apartment. The spare room is rented for 10 days. He uses the apartment as his primary residence for the entire year. When the room is not listed, he uses the room as his library and for storage. Income generated from the rental of his spare room is $2,000. Cleaning expenses and utilities expenses associated with the rental is $200. Property tax and mortgage interest attributable to the spare room is $200.

Since the room is used by the host for personal purpose for more than 14 days and is rented out for less than 15 days, rental income of $2,000 does not need to be reported on his tax return. However, he is also not allowed a deduction for the cleaning and utilities expenses incurred. He can deduct $200 of property tax and mortgage interest on his schedule A if he chooses to itemize his deduction.

Example: A host rents an apartment from her landlord (and is not the owner of the property) for $1,500 a month. She lists the apartment with Airbnb and rents the apartment to a 3rd party for 20 days in June for $1,500 while she is out of town.

Host will report $1,500 gross rental income and can also report $1,000 ($1,500 * 20/30) of rent payment made to her landlord as a rental expense.

Example: A host shares a 2 bedroom apartment with his roommate. He lists his bedroom on Airbnb while he is gone for a 2 months long vacation. Rental income generated is $4,000. Cleaning expense for his bedroom is $500. Utilities expenses (electricity, internet and water) for the entire apartment are $4,800 per year. The host's room is the same size as his roommate's.

The host is able to deduct cleaning expense of $500 as it is incurred solely for rental purposes. The host splits the utilities expenses equally with his roommate as their rooms are of the same size. Rental period is 60 days out of a total of 365 days for the year. Only $395 of utilities expenses ($4,800/2 * 60/365) are deductible as the remaining are not attributable to the rental activity. His net rental income is $3,105 ($4,000 - $500 - $395). In this example, two methods are used to pro-rate expenses between personal and rental uses.

6. Repairs & maintenance vs. improvements – deduct or capitalize

You must capitalize any expense you pay to improve your rental property. An expense is for an improvement if it results in betterment to your property, restores your property, or adapts your property to a new or different use.

- Betterment – Expenses that may result in betterment to your property include expenses for fixing a pre-existing defect or condition, enlarging or expanding your property, or increasing the capacity, strength, or quality of your property.
- Restoration – Expenses that may be for restoration include expense for replacing a substantial structural part of your property, repairing damage to your property after you properly adjusted the basis of your property as a result of a casualty loss, or rebuilding your property to a like-new condition.
- Adaptation – Expense that may be for adaptation include expenses for altering your property to a use that is not consistent with the intended ordinary use of your property when you began renting the property.

If the expenses incurred do not prolong the useful life or add to value, they are deductible currently as a repair. It is the "nature" of the repair rather the "amount" that determines whether it is deductible or not.

Examples of repairs:

- Reinforcing sagging floors
- Resurfacing a parking lot

Example of improvements:

- Replacing a floor
- Replacement of a gravel driveway with a cement driveway

It may be confusing to taxpayers which repair and maintenance expenses are currently deductible and which must be capitalized. In 2013, the IRS issued final tangible property regulations to help taxpayers determine whether certain costs are currently deductible or must be capitalized. The final tangible property regulations also contain several simplifying provisions that are elective and prospective in application. For example, the election to apply the de minimis safe harbor eliminates the burden of determining whether every small-dollar expenditure for the acquisition or production of property is properly deductible or capitalized. If you elect to use the de minimis safe harbor, you don't have to capitalize the cost of qualifying de minimis acquisitions or improvements. Other elections include the election to utilize the safe harbor for small taxpayers, and the election to capitalize repair and maintenance costs in accordance with books and records. Please consult your tax advisor on the application of these new regulations and elections to your rental property.

7. Depreciation

Homeowners can recover the cost of rental property through yearly tax deductions. Residential tenants are not allowed such deductions generally. Cost of rental property includes the cost of acquisitions and capitalized expenses discussed in the previous section. You recover the cost through depreciation over a recovery period of 27.5 years *(see section 9 "How to report rental income and expenses")*.

Three factors determine how much depreciation you can deduct each year: (1) your **basis** in the property, (2) the **recovery period** for the property, and (3) the **depreciation method** used.

(1) Your **basis** of the property is generally the purchase price of the property, plus any settlement fees and closing costs you incurred. Legal fees, recording fees, transfer taxes, abstract fees and owner's title insurance are examples of closing cost you need to add to your basis of the property. Amounts placed in escrow for the future payment of items such as taxes and insurance are not included as settlement costs and hence not included as part of your basis.

Land, while is included in part of the basis of your property, is not depreciated as land generally does not wear out, become obsolete or get used up. To figure out the basis of property that is depreciable (i.e. to carve out what is not attributable to land), you can refer to your property tax bill. The property tax bill will generally show you the value of land assessed by the county assessor for the county the property is located.

As discussed above, expenses incurred to improve your property are capitalized and are added to your basis in the property as well. However, treat additions or improvements you make to your property as separate property items for depreciation purposes.

(2) The **recovery period** for the property represents the number of years over which you will depreciate the property. For residential buildings and improvements made thereto, the recovery period is 27.5 years or 330 months. The recovery period starts when the property is placed in service. The recovery period for an addition or improvement to property begins on the later of (a) the date the addition or improvement is placed in service, or (b) the date the property to which the addition or improvement was made is placed in service. If you make improvements to a property after the property was already placed in service, the recovery period for the improvements would start later than that of the property.

Example: You rent out a residential apartment that you own in year 1 (i.e. you place your apartment in service in year 1.) In year 2, you make improvements to the apartment and capitalize the cost accordingly. Both the apartment and the improvement made thereto have a recovery period of 27.5 years, but are tracked separately for depreciation purposes. Depreciation of the apartment starts in year 1 and depreciation of the improvement starts in year 2. Assuming a full year of depreciation for both years, at the end of year 2, the remaining life of the apartment for depreciation is 25.5 (27 minus 2) years while the remaining life of the improvement is 26.5 (27 minus 1).

(3) The current **depreciation method** used is Modified Accelerated Cost Recovery System (MACRS). Under MACRS, residential buildings are depreciated under the straight-line method and mid-month convention. The straight-line method means you depreciate your property pro-rata over the years of the recovery period. Under the mid-month convention, you treat all property placed in service or disposed of during a month as placed in service or disposed of at

the midpoint of the month. This means that a one-half month of depreciation is allowed for the month the property is placed in service or disposed of.

Example: You purchased your home on June 1, 2016 for $995,000. As part of the purchase, you paid legal fees and recording fees (closing cost) of $5,000. You started renting out the property immediately after your purchase. Assume that the land has been assessed at $200,000 and the building has been assessed at $800,000.

The basis of your rental property is $1,000,000 (purchase price of $995,000 plus closing cost of $5,000). Land assessed to have a value of $200,000 is not depreciable. The depreciable basis of your rental property is $800,000 ($1,000,000 - $200,000). The number of months in 2016 which you will depreciate your rental property for is 6.5 (0.5 for June when you place your rental property in service and 6 from July to December.) The amount of depreciation allowed for 2016 is $800,000/330 * 6.5 = $15,758.

Other assets used for rental purposes can also be depreciated, for example, furniture and appliances used in the rental property are generally depreciated over 5 years. Please refer to IRS Publication 527 "Residential Rental Property" and 946 "How To Depreciate Property" for more details on each asset's recovery period and depreciation method.

8. Limit on rental losses

If you incur more rental expense than your rental income, you have a loss from your rental real estate activity. Two sets of rules may limit the amount of loss you can deduct. You must consider these rules in the order shown below.

(1) **At-risk rule** (for real property placed in service after 1986)

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.

Example: You purchased a house for $500,000 with cash of $200,000 and mortgage of $300,000. The mortgage is secured by your house. The amount you are at risk for is $500,000. If your rental loss is less than $500,000, the rental loss is deductible. Any loss beyond $500,000 is not deductible under the at-risk rule.

Example: If you list the apartment that you are renting and you pay $500 for cleaning supplies to get it ready for a Guest, the amount you are at risk for the rental activity is $500.

(2) Passive activity limits

Generally, rental real estate activities are considered passive activities and losses are not deductible unless you have income from other passive activities to offset them. Any excess loss is carried forward to the next tax year.

Exception to the passive activity limit:

(a) Exception for rental real estate activities with active participation

If you actively participated in a rental real estate activity, you may be able to deduct up to $25,000 of loss from the rental activity from your nonpassive income. This special allowance is an exception to the general rule disallowing passive losses in excess of passive income from passive activities discussed above.

You are considered as actively participating in a rental real estate activity if you 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 similar decisions.

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 modified adjusted gross income (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.

Example: You listed a house that you own for rent for 9 months in 2016 for a total of $27,000 and incurred rental expenses of $30,000. Your rental loss in 2016 is $3,000 ($30,000-$27,000). This rental activity is the only passive activity you had during 2016.

You can deduct rental expense up to your rental income of $27,000. The remaining $3,000 is suspended and carried forward to future tax years.

If you actively host by setting the price of your listing, setting up house rules, arranging cleaning and repairing services, deciding which request to book to accept, etc., you may be able to deduct the remaining $3,000 under the exception, depending on your specific circumstances, such as, filing status, income level, etc.

(b) Exception for real estate professionals

The passive activity limit does not apply to materially participating real estate professionals. To be considered as such, you have to satisfy several requirements. For a detailed discussion of the requirements, see IRS Publication 527 "Residential Rental Property" and 925 "Passive Activity and At-Risk Rules".

Losses disallowed due to at-risk rules and passive activity limit are carried forward indefinitely until they can be used to offset net rental income in future years. At the year you dispose of the rental real estate activity, for example, when you sell your rental property, you are allowed to deduct all previously suspended and carried over rental losses due to at-risk rules and passive activity limit.

Please consult your tax advisor on the application of these loss limitations to your rental property.

9. How to report rental income and expenses

Rental income and expenses are reported on Schedule C or Schedule E of your tax return (Form 1040). If you are a real estate dealer who is engaged in the business of selling real estate to customers with the purposes of making a profit or an owner of a hotel, motel, etc., who provides services (maid services, etc.) for guests, report the rental income and expenses on Schedule C. If you are not, report the rental income and expenses on Schedule E. Schedule C income may be subject to self-employment tax, while Schedule E income may be subject to Net Investment Income Tax.

Most individual taxpayers report residential rental income and expenses on Schedule E. See Exhibit A for a copy of page 1 of Schedule E.

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 properties, complete and attach as many Schedules E as are needed to list the properties. Complete lines 1 and 2 for each property. However, fill in lines 23a through 26 on only one Schedule E.

On Schedule E, page 1, line 18, enter the depreciation you are claiming for each property. To find out if you need to attach Form 4562, see Form 4562, in chapter 3 of IRS Publication 527.

If you have a loss from your rental real estate activity, you also may need to complete one or both of the following forms. These forms will need to be completed year to year to keep track of disallowed loss due to at-risk rule or passive activity limit.

- Form 6198, At-Risk Limitations. See At-Risk Rules, earlier.
- Form 8582, Passive Activity Loss Limitations. See Passive Activity Limits, earlier.

Page 2 of Schedule E is used to report income or loss from partnerships, S corporations, estates, trusts, and real estate mortgage investment conduits, which are out of the scope of this guidance. If you need to use page 2 of Schedule E, be sure to use page 2 of the same Schedule E you used to enter 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).

Please consult with your tax advisor on reporting rental income and expenses on Schedule C (Form 1040) if you are a real estate dealer or owner of a hotel, motel, etc.

10. How to report deductible personal expenses

As discussed, there are occasions where you must prorate your expenses related to your property between personal and rental uses. Certain expenses attributable to personal use, for example, mortgage interest and real estate taxes can be deducted on Schedule A (Form 1040) if you choose to itemize you deductions. You cannot deduct these expenses if you choose to take the standard deduction instead. See Exhibit B for a copy of Schedule A.

11. Reporting payments to independent contractors

If you make $600 or more in payments to independent contractors for services performed on your rental property, you are required to issue 1099-MISC to the independent contractors and submit a copy to the IRS. See IRS instruction on how to complete 1099-MISC.

12. How is (net) rental income taxed (Federal)

For federal income tax purposes, net rental income is taxed at ordinary income tax rates, subject to the limitations discussed above. Ordinary income tax rates vary, depending on your filing status and overall income levels. See Exhibit C and D for 2016 and 2015 ordinary income tax rates for individual taxpayers.

If you are required to report income and expenses from your rental activity on Schedule C, you may be subject to self-employment tax. If you are required to report income and expenses from your rental activity on Schedule E, you may be subject to Net Investment Income Tax. Please consult your tax advisor for more details on your specific circumstances.

13. How is (net) rental income taxed (States)

Net rental income may also be subject to state income tax based on factors including the respective states' income tax system, residency or domicile of the host and the location of the rental property. Please consult your tax advisor for state income tax reporting requirements.

14. Quarterly estimated tax payments

Estimated tax is the method used to pay tax on rental income not subject to withholding. If you do not pay enough tax through withholding or estimated tax, you may be subject to a penalty. Please consult your tax advisor for more details on your specific circumstances.

15. Sale of home used as rental property

For homeowners, if you have a gain from the sale of your main home, you may qualify to exclude up to $250,000 of that gain from your income. You may qualify to exclude up to $500,000 of that gain if you are married and file a joint return with your spouse.

To qualify for this exclusion, you have to meet the ownership test and the use test. Also, you are not eligible for the exclusion if you excluded the gain from the sale of another home during the two-year period prior to the sale of your home. Please refer to IRS Publication 523 for the complete eligibility requirements.

Generally, the time you rent out your main home is considered as period of nonqualified use. No exclusion of gain is allowed to the extent that the gain is associated with a period of nonqualified use. You may be able to exclude gain from the sale of a home you have used for rental purposes, but you must meet the ownership and use tests. The gain resulting from the sale of the property is allocated between qualified and nonqualified use periods based on the amount of time the property was held for qualified and nonqualified use. Gain from the sale or exchange of a main home allocable to periods of qualified use will continue to qualify for the exclusion for the sale of your main home. Gain from the sale or exchange of property allocable to nonqualified use will not qualify for the exclusion.

Limitation on exclusion also applies to gain from sale from property that you use partly as home and partly as rental property. Please refer to IRS Publication 523 for the complete discussion on these limitations on the exclusion amount.

16. Documents to be retained

All supporting documentation with respect to rental income and expenses must be kept for tax purposes regardless of the length of the rental period. Even if you do not have to report rental income because of the 15-day exception *(See section 2 "Rental Income – Exemption")*, you still need to retain all documentation. You do not need to submit the supporting documentation with your return. However, the IRS may request copies of the documentation. You should keep a record of the following:

- Receipts for all deductible expenses, including supplies, cleaning services, etc.
- Records of tenant-paid improvements, real estate taxes, mortgage payments, etc.
- A log of how many days a property is rented, used for personal purposes, or vacant
- Proof of advertising vacant properties in newspapers, magazines, websites, etc.
- Lists distinguishing the nature of each repair or improvement
- Receipts for each repair and improvement including date and amount paid
- A log of travel expenses allocating between rental and non-rental purposes
- A schedule showing method of division of expenses if part of property is rented
- Schedule listing depreciable assets with respect to the rental property including amount, date purchased, life of asset, method of depreciation, and depreciation already taken
- Carryforward of passive activity losses not utilized in prior years
- Carryforward of rental losses in excess of $25,000 when actively participating in rental activity
- Form 1098 or other form indicating mortgage interest paid

- Property tax forms and receipts
- Proof of tax preparation fees paid in relation to rental property
- Security deposit information
- Form 1099-MISC issued to independent contractors

Generally, you must keep records that support items shown on your return until the period of limitations for that return runs out. The period of limitation is the period of time in which you can amend your return to claim a credit or refund or the IRS can assess additional tax.

If you	Then the period of limitation is
(a) Owe additional tax and (b), (c), and (d) do not apply to you	3 years
(b) Do not report income that you should and it is more than 25% of the gross income shown on your return	6 years
(c) File a fraudulent return	No limit
(d) Do not file a return	No limit
(e) File a claim for credit or refund after you filed your return	The later of 3 years or 2 years after tax was paid
(f) File a claim for a loss from worthless securities	7 years

Additionally, you should keep records relating to property until the period of limitations expires for the year in which you dispose of the property. You must keep these records to figure any depreciation deduction and to figure the gain or loss when you sell or otherwise dispose of the property.

If you received property in a nontaxable exchange, your basis in that property is the same as the basis of the property you gave up, increased by any money you paid. You must keep the records on the old property, as well as on the new property, until the period of limitations expires for the year in which you dispose of the new property.

If you do not keep the requisite records, it may be impossible for you to prove that you incurred deductible expenses or to establish your basis for gain or loss. Without such proof the IRS can deny you a deduction.

When your records are no longer needed for tax purposes, do not discard them until you check to see if you have to keep them longer for other purposes. For example, your insurance company or creditors may require you to keep them longer than the IRS does.

17. Useful References

Below is a list of resources that you can reference for a more thorough explanation on the topics discussed above.

IRS Publications:

- 523 Selling Your Home
- 527 Residential Rental Property
- 534 Depreciating Property Placed in Service Before 1987
- 535 Business Expenses
- 925 Passive Activity and At-Risk Rules
- 946 How To Depreciate Property

Forms & Instructions:

- 4562 Depreciation and Amortization
- 8582 Passive Activity Loss Limitations
- Schedule E (Form 1040) Supplemental Income and Loss
- 1099-MISC Miscellaneous Income

Exhibit A – Page 1 of Schedule E (Form 1040)

SCHEDULE E (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Supplemental Income and Loss
(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)
▶ Attach to Form 1040, 1040NR, or Form 1041.
▶ Information about Schedule E and its separate instructions is at www.irs.gov/schedulee.

OMB No. 1545-0074
2016
Attachment Sequence No. 13

Name(s) shown on return | Your social security number

Part I **Income or Loss From Rental Real Estate and Royalties** Note: If you are in the business of renting personal property, use Schedule C or C-EZ (see instructions). If you are an individual, report farm rental income or loss from Form 4835 on page 2, line 40.

A Did you make any payments in 2016 that would require you to file Form(s) 1099? (see instructions) ☐ Yes ☐ No
B If "Yes," did you or will you file required Forms 1099? ☐ Yes ☐ No

1a	Physical address of each property (street, city, state, ZIP code)
A	
B	
C	

1b	Type of Property (from list below)	2 For each rental real estate property listed above, report the number of fair rental and personal use days. Check the QJV box only if you meet the requirements to file as a qualified joint venture. See instructions.		Fair Rental Days	Personal Use Days	QJV
A			A			☐
B			B			☐
C			C			☐

Type of Property:
1 Single Family Residence 3 Vacation/Short-Term Rental 5 Land 7 Self-Rental
2 Multi-Family Residence 4 Commercial 6 Royalties 8 Other (describe)

Income:	Properties:		A	B	C
3	Rents received	3			
4	Royalties received	4			
Expenses:					
5	Advertising	5			
6	Auto and travel (see instructions)	6			
7	Cleaning and maintenance	7			
8	Commissions	8			
9	Insurance	9			
10	Legal and other professional fees	10			
11	Management fees	11			
12	Mortgage interest paid to banks, etc. (see instructions)	12			
13	Other interest	13			
14	Repairs	14			
15	Supplies	15			
16	Taxes	16			
17	Utilities	17			
18	Depreciation expense or depletion	18			
19	Other (list) ▶	19			
20	Total expenses. Add lines 5 through 19	20			
21	Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file Form 6198	21			
22	Deductible rental real estate loss after limitation, if any, on Form 8582 (see instructions)	22	( )	( )	( )

23a	Total of all amounts reported on line 3 for all rental properties	23a	
b	Total of all amounts reported on line 4 for all royalty properties	23b	
c	Total of all amounts reported on line 12 for all properties	23c	
d	Total of all amounts reported on line 18 for all properties	23d	
e	Total of all amounts reported on line 20 for all properties	23e	
24	**Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	
25	**Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25	( )
26	**Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Form 1040, line 17, or Form 1040NR, line 18. Otherwise, include this amount in the total on line 41 on page 2	26	

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11344L **Schedule E (Form 1040) 2016**

Input information regarding the rental property on line 1 and 2. Be sure to enter the number of days related to rental v. personal use. If you have more than three rental properties, complete as many Schedule E as you need.

Report gross rental income on line 3 and expenses from line 5 to line 20. Airbnb service fee is reported on line 11. Depreciation is reported on line 18.

Only complete line 23 to line 26 once, even if you file more than one Schedule E.

Exhibit B – Schedule A (Form 1040)

SCHEDULE A (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Itemized Deductions

▶ Information about Schedule A and its separate instructions is at *www.irs.gov/schedulea*.
▶ Attach to Form 1040.

OMB No. 1545-0074
2016
Attachment Sequence No. 07

Name(s) shown on Form 1040 | Your social security number

Medical and Dental Expenses		**Caution:** Do not include expenses reimbursed or paid by others.		
	1	Medical and dental expenses (see instructions)	1	
	2	Enter amount from Form 1040, line 38 | 2 |		
	3	Multiply line 2 by 10% (0.10). But if either you or your spouse was born before January 2, 1952, multiply line 2 by 7.5% (0.075) instead	3	
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-		4
Taxes You Paid	5	State and local (check only one box):		
		a ☐ Income taxes, or b ☐ General sales taxes	5	
	6	Real estate taxes (see instructions)	6	
	7	Personal property taxes	7	
	8	Other taxes. List type and amount ▶	8	
	9	Add lines 5 through 8		9
Interest You Paid **Note:** Your mortgage interest deduction may be limited (see instructions).	10	Home mortgage interest and points reported to you on Form 1098	10	
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ▶	11	
	12	Points not reported to you on Form 1098. See instructions for special rules	12	
	13	Mortgage insurance premiums (see instructions)	13	
	14	Investment interest. Attach Form 4952 if required. (See instructions.)	14	
	15	Add lines 10 through 14		15
Gifts to Charity If you made a gift and got a benefit for it, see instructions.	16	Gifts by cash or check. If you made any gift of $250 or more, see instructions	16	
	17	Other than by cash or check. If any gift of $250 or more, see instructions. You must attach Form 8283 if over $500	17	
	18	Carryover from prior year	18	
	19	Add lines 16 through 18		19
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See instructions.)		20
Job Expenses and Certain Miscellaneous Deductions	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.) ▶	21	
	22	Tax preparation fees	22	
	23	Other expenses—investment, safe deposit box, etc. List type and amount ▶	23	
	24	Add lines 21 through 23	24	
	25	Enter amount from Form 1040, line 38 | 25 |		
	26	Multiply line 25 by 2% (0.02)	26	
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-		27
Other Miscellaneous Deductions	28	Other—from list in instructions. List type and amount ▶		28
Total Itemized Deductions	29	Is Form 1040, line 38, over $155,650? ☐ **No.** Your deduction is not limited. Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40. ☐ **Yes.** Your deduction may be limited. See the Itemized Deductions Worksheet in the instructions to figure the amount to enter.		29
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here ▶ ☐		

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Report real estate taxes (personal) on line 6.

Report home mortgage interest (personal) on line 10 or 11, depending if you receive a 1098.

For other deductible personal expenses, consult your tax advisor on correct reporting on Schedule A.

Exhibit C – 2016 Tax Rates for Individual Taxpayers

Single

Taxable Income	Tax Rate
$0 to $9,275	10%
$9,276 to $37,650	$927.50 plus 15% of the amount over $9,275
$37,651 to $91,150	$5,183.75 plus 25% of the amount over $37,650
$91,151 to $190,150	$18,588.75 plus 28% of the amount over $91,150
$190,151 to $413,350	$46,278.75 plus 33% of the amount over $190,150
$413,351 to $415,050	$119,934.75 plus 35% of the amount over $413,350
$415,051 or more	$120,529.75 plus 39.6% of the amount over $415,050

Married Filing Joint Returns and Surviving Spouses

Taxable Income	Tax Rate
$0 to $18,550	10%
$18,551 to $75,300	$1,855.00 plus 15% of the amount over $18,550
$75,301 to $151,900	$10,367.50 plus 25% of the amount over $75,300
$151,901 to $231,450	$29,517.50 plus 28% of the amount over $151,900
$231,451 to $413,350	$51,791.50 plus 33% of the amount over $231,450
$413,351 to $466,950	$111,818.50 plus 35% of the amount over $413,350
$466,951 or more	$130,578.50 plus 39.6% of the amount over $466,950

Married Filing Separate Returns

Taxable Income	Tax Rate
$0 to $9,275	10%
$9,276 to $37,650	$927.50 plus 15% of the amount over $9,275
$37,651 to $75,950	$5,183.75 plus 25% of the amount over $37,650
$75,951 to $115,725	$14,758.75 plus 28% of the amount over $75,950
$115,726 to $206,675	$25,895.75 plus 33% of the amount over $115,725
$206,676 to $233,475	$55,909.25 plus 35% of the amount over $206,675
$233,476 or more	$65,289.25 plus 39.6% of the amount over $233,475

Exhibit C – 2016 Tax Rates for Individual Taxpayers

Head of Household

Taxable Income	Tax Rate
$0 to $13,250	10%
$13,251 to $50,400	$1,325.00 plus 15% of the amount over $13,250
$50,401 to $130,150	$6,897.50 plus 25% of the amount over $50,400
$130,151 to $210,800	$26,835.00 plus 28% of the amount over $130,150
$210,801 to $413,350	$49,417.00 plus 33% of the amount over $210,800
$413,351 to $441,000	$116,258.50 plus 35% of the amount over $413,350
$441,001 or more	$125,936.00 plus 39.6% of the amount over $441,000

Exhibit D – 2015 Tax Rates for Individual Taxpayers

Single

Taxable Income	Tax Rate
$0 to $9,225	10%
$9,226 to $37,450	$922.50 plus 15% of the amount over $9,225
$37,451 to $90,750	$5,156.25 plus 25% of the amount over $37,450
$90,751 to $189,300	$18,481.25 plus 28% of the amount over $90,750
$189,301 to $411,500	$46,075.25 plus 33% of the amount over $189,300
$411,501 to $413,200	$119,401.25 plus 35% of the amount over $411,500
$413,201 or more	$119,996.25 plus 39.6% of the amount over $413,200

Married Filing Joint Returns and Surviving Spouses

Taxable Income	Tax Rate
$0 to $18,450	10%
$18,451 to $74,900	$1,845.00 plus 15% of the amount over $18,450
$74,901 to $151,200	$10,312.50 plus 25% of the amount over $74,900
$151,201 to $230,450	$29,387.50 plus 28% of the amount over $151,200
$230,451 to $411,500	$51,577.50 plus 33% of the amount over $230,450
$411,501 to $464,850	$111,324.00 plus 35% of the amount over $411,500
$464,851 or more	$129,996.50 plus 39.6% of the amount over $464,850

Married Filing Separate Returns

Taxable Income	Tax Rate
$0 to $9,225	10%
$9,226 to $37,450	$922.50 plus 15% of the amount over $9,225
$37,451 to $75,600	$5,156.25 plus 25% of the amount over $37,450
$75,601 to $115,225	$14,693.75 plus 28% of the amount over $75,600
$115,226 to $205,750	$25,788.75 plus 33% of the amount over $115,225
$205,751 to $232,425	$55,662.00 plus 35% of the amount over $205,750
$232,426 or more	$64,998.25 plus 39.6% of the amount over $232,425

Exhibit D – 2015 Tax Rates for Individual Taxpayers

Head of Household

Taxable Income	Tax Rate
$0 to $13,150	10%
$13,151 to $50,200	$1,315.00 plus 15% of the amount over $13,150
$50,201 to $129,600	$6,872.50 plus 25% of the amount over $50,200
$129,601 to $209,850	$26,772.50 plus 28% of the amount over $129,600
$209,851 to $411,500	$49,192.50 plus 33% of the amount over $209,850
$411,501 to $439,000	$115,737.00 plus 35% of the amount over $411,500
$439,001 or more	$125,362.00 plus 39.6% of the amount over $439,000

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