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TAX PREP GUIDE

For Rental Property Owners

2025 EDITION

Table of Contents

INTRODUCTION

The next tax season is always coming faster than you think - or is most likely already here, if you are reading this. Whether you have just started your rental property journey or are a seasoned investor, you have a legal requirement to report your rental income and expenses to the IRS. We're here to hopefully make that process a little less mysterious, and ideally a little easier, this year.

This guide is about how to get ready for taxes this year, right now – because if you're reading this, that is probably what you need to know. Many rental property tax guides are focused on strategy and how to optimally structure your real estate investments to pay the minimum amount of tax possible. And that's great! But sometimes we don't have the luxury of pondering hypotheticals and crafting our ideal portfolio in our heads; sometimes it is time to get stuff done.

So in the following pages, we will not be focusing on juicy topics like choosing the best entity type to hold rental property in, cost segregation studies, bonus depreciation, home office deductions, and so on and so forth. It's not that they are not relevant or important or impactful, but rather that they are complex topics, often with prerequisites and advanced decisions required, that you should discuss with your CPA or financial professional at some point when you are not trying to pull your income and expenses together for tax time.

Rather, this guide is focused on helping you prepare your Profit & Loss or Schedule E for each of your properties. This is the key data that is *your* responsibility as a rental property owner to produce and provide to your tax preparer or tax preparation software, so that *they* can help you file your taxes and help you decide what additional or advanced strategies you have available now, or should consider in the future.

Remember - your CPA is only as good as the information that you give them! And you are the one responsible for that information's accuracy. Let's get started!

WHO IS THIS FOR?

We have already said that this is a rental property tax guide - but we need to go a step further and define exactly who and what kind of investment property owner we are going to focus on. There are lots of different ways to be involved in rental property, and not all of them need to keep their books, or file their taxes, in exactly the same ways.

For example, someone who owns a few rental properties, a professional property manager, and a limited partner in a real estate fund will all file very different tax forms related to their involvement in rental property.

INDIVIDUAL OR PASS-THROUGH OWNERSHIP

For this guide, we will be focusing on the needs of the individual rental owner that holds their property either in their own name, or in a pass-through entity like a single member LLC. These investors will report their rental income and expenses on their personal tax return via the IRS Schedule E form.

There are 10+ million people in the United States who fit this description - making rental property ownership one of the most popular and common investment strategies in the country. So if you're reading this - there are good odds you are exactly who we are writing for!

Landlords need to file different types of tax forms depending on their activities and ownership structure.

Ownership Structure and IRS Form		
Individual ownership or Pass-through LLC	Partnership or Multi-member LLC	Third party or professional property management
Schedule E	Form 1065 and 8825	Schedule C

For the purposes of your tax filings, the management style and duration of your rentals are irrelevant. It does not matter if you self-manage your rentals, or have a property manager who does so on your behalf. Similarly, it doesn't matter to your taxes if your rentals are long, medium, or short term. Either way, you as the property owner are responsible for accurately reporting your rents and deductible expenses.

Of course, your sources of revenue and expense data will differ based on the above. Someone utilizing a property manager will get a large portion of their information from their property management statements, and someone running short term rentals will get most of their financial information from Airbnb or VRBO's payout statements.

However your property is managed and however long your tenants or guests stay, if you own the property directly or in a pass-through entity you will report your revenues and expenses to the IRS on the Schedule E form. And this guide is for you!

Different types of rental activity that can be reported on the Schedule E:

- Residential and commercial rentals
- Long term rentals
- Medium term or furnished rentals
- Short term or vacation rentals
- House hacks or owner occupied multi-family
- Renting out a second home part of the year
- Self managed or professionally managed rentals

PARTNERSHIPS AND MULTI-MEMBER LLCs

Many investors seek to leverage not only their own funds, but also to partner with other investors to pool resources and scale further, faster. Once there are multiple owners involved, no one can hold the property in their individual name or in an entity that passes through directly to their personal tax return. As a result, the partnership or multi-member LLC needs to file its own tax return and provide forms (K-1s) to each member for use in their personal tax filings.

By and large though, the day to day bookkeeping and preparation of property by property income and expenses for tax time is very similar to how individuals or pass-through entities need to do it. Partnerships report property numbers on Form 8825 instead of the Schedule E, but the two forms are very similar.

Individual/ LLC

- Property based reporting
- Included on personal 1040 tax return
- Rental income and expenses filed on Schedule E

Partnership/ Multi-member LLC

- Property based reporting
- Entity files a 1065 tax return, with rental income and expenses filed on Form 8825
- Owners receive a Schedule K-1 with their portion of net income to include with their personal 1040 tax return

The primary differences are that the 8825 includes a category for wages and salaries (not present on the Schedule E) and only has one category for interest expenses (the Scheduе E has 'mortgage interest' and 'other interest (non-mortgage)' as two separate categories).

So while this guide won't focus on partnerships, much of this content should still be helpful.

SPLIT PERSONAL AND RENTAL USE

There is also a substantial subset of people who have properties that are split between personal and rental use. This most often comes in two flavors: house-hacks where you live in one part of the property and rent out the other, and vacation or second homes where you rent out the home for only part of the year.

In either case, if the property is owned individually or in a pass-through entity you will still file a Schedule E for the property. The key distinction is that you will only be able to claim the portion of the total costs that relate to rental use, and none of the costs related to your personal use of the property. Of course, all rental income will need to be reported as well.

House Hacks

For house-hacks, you will be able to claim expenses related to the part of the property in rental use, and will not be able to deduct any expenses related to the part of the property in personal use. This includes renting rooms in your primary residence, as well as occupying one unit of a multi-family home.

To simplify bookkeeping and reporting for house hacks, we recommend tracking the property as a multi-unit, even if you are renting rooms or parts of your single-family residence. This gives you a unit to record each portion of your costs, as well as the overall property to record shared costs.

Expenditures that encompass both the rental and personal portions of the home (such as exterior landscaping, for example) will need to be prorated at the ratio of rental to personal use. So if you owned a duplex where each unit was the same size, you would be able to claim 50% of expenditures that applied to both units.

Vacation or Second Homes

For vacation or second homes where the space is not shared, but is used at times as a rental and at other times personally, the concept is similar and based on the ratio of rental days vs personal use days. If you have a beach property that is rented for 3 months every summer but not the rest of the year, approximately ¼ of the total property costs would be deductible.

The Augusta Rule

There is an exception to the above rule for very few short periods of rental use, often referred to as The Augusta Rule. If you rent the property out for 14 days or less each year, you are not required to report that rental income or file a Schedule E.

Click here to learn more seasonal rental income and the potential for tax free rent!

For the remainder of this guide, we will be presuming that your rental properties are 100% rental use for simplicity and clarity. In general the advice will still be applicable to property owners with split personal and rental use - just remember that you have to prorate!

Who is this for?

This guide is focused on individual rental property owners who file IRS Schedule Es in cash basis. That being said, many of the bookkeeping best practices are generally applicable to other types of property investors or ownership structures.

KEY CONSIDERATIONS FOR RENTAL ACCOUNTING

There are multiple ways in which bookkeeping for rental properties differs from other types of business and income producing activity. There are also some general bookkeeping concepts that some investment property owners may not be familiar with, and therefore warrant a mention. Let's dive in!

THE SCHEDULE E: FOR PASSIVE ACTIVITY

First of all, the majority of rental property owners file their taxes on the IRS Schedule E. This is different from the majority of small businesses with similar ownership structures (sole proprietors and single-member LLCs) who file on the IRS Schedule C form.

As briefly mentioned above, this is because the IRS categorizes rental property income as passive income derived from ownership of an asset, as opposed to the active income derived from providing a service or selling something like most other small businesses. The Schedule E is the form used to report revenue and expenses from passive sources like rental property and intellectual property, and the Schedule C is property, while the Schedule C is for active businesses you operate or professions you practice.

W2 income from traditional employment is also considered active income (but is reported on your 1040 personal return, not the Schedule C).

This distinction has both tax and bookkeeping implications. Not only does passive activity and active activity get filed on different forms, but the IRS treats each source of income as a separate bucket.

This means that passive and active income or losses aren't compared to each other or netted out. If you show a substantial amount of active income from a business or employment, you can't use losses from passive income (remember that many rental property owners show losses on their taxes) to reduce your total taxable income. Active can go against active and passive against passive, but not against each other.

Therefore, if you show a loss on your taxes from your rental activities, you cannot use it to reduce your active taxable net income. You can, however, carry that loss forward into future tax years to reduce your tax burden for future passive income.

PER PROPERTY REPORTING REQUIREMENT

In terms of bookkeeping implications, the fact that passive income is derived from ownership means that the IRS wants to see your revenues and expenses for each piece of property (real or intellectual) broken out separately. This is different than a traditional small business, where you also need to report your revenues and expenses, but generally can do so in aggregate for the entire business.

When you look at the Schedule E form, there is a different column for each property you own. So you will not simply be able to combine all the rents and expenses for all the properties you own - you will need to break all those numbers down into the specific and accurate per-property amounts.

This is one of the most foundational requirements of rental property bookkeeping, and there are a few different ways to help you achieve it.

Some investors open a separate bank account for each property to structurally ensure that they will always be able to know which of their transactions are associated with which property. This works well - up until the point that your portfolio has expanded and you have too many accounts or debit cards to easily manage and juggle at the store. It also does not give you an easy way to handle transactions that apply to more than one or all of your properties, such as software subscriptions and professional fees.

A more scalable solution is using accounting software - especially one that allows you track revenues and expenses for multiple different properties. If you are not using software built for real estate it may use a different terminology, such as classes or projects, that would allow you to pull your reports on a per-property basis. Do be aware that generic small business accounting software will typically only include that functionality in higher tier or more expensive plans.

Property by property tracking is, of course, default functionality in all of TurboTenant Accounting's plans! **Learn More >>**

WHAT ABOUT TRANSACTIONS THAT APPLY TO MORE THAN ONE PROPERTY?

While the majority of expenses are applicable to just one specific property, that is not universally true. Consider software subscriptions that are used for your entire portfolio, your CPA bill after tax time, or even a lawn care service utilized at 2 of your 5 properties but invoices them together. This type of expense is also often referred to as overhead.

These costs can be substantial and are not automatically broken out by property for you when they hit your bank account. But since you are supposed to report your expenses on a property by property basis - how do you handle these transactions and ensure you receive your total deductions?

There are two primary ways to get these portfolio-level transactions down onto your specific property books. First, you can 'split' the lump sum transaction into the appropriate per property amount, and assign a piece to each property to which it applies. This ensures that the correct portion of the expense is associated with the correct property for accurate end of year reporting.

Most accounting software offers the ability to split transactions, or it can be done manually if keeping your books on a spreadsheet. Especially if the expense applies to some, but not all, of your properties, splitting the transaction is the best way to ensure it is reflected on the correct property Schedule Es.

Second, if you are using accounting software designed for real estate, you can assign transactions that apply to all of your properties to the 'portfolio' level, and allow the software to automatically pro-rate those expenses across all of your properties on your Schedule E. This can be a large time saver, especially for those with larger portfolios, because it allows you to skip the process of splitting each transaction into the per property amount.

Did you know?

TurboTenant Accounting is accounting software built for rentals: including the ability to record and report transactions to units, properties, and your entire portfolio or entity.

CASH BASIS

When you file taxes for your rental property, you elect to use either the cash basis method of accounting, or the accrual basis method of accounting. The vast majority of rental property owners elect to file in cash basis, due to its straightforwardness.

In cash basis, transactions are recorded and reported when they occur. If you pay for 6 months of landscaping service in March, you record the full expense in March. It's just that simple!

This makes your bookkeeping simpler, but can make your monthly or quarterly reports look a little skewed if you pay for a lot of things upfront or in lump sums. Of course, those reports would accurately reflect when you spent that money.

In accrual basis, transactions are reported for the time period for which they apply. If you pay for 6 months of landscaping service in March, you report 1/6th of the total expense in each month that you receive the landscaping service, regardless of when you paid for it.

This requires a bit more bookkeeping work, but can make your monthly and quarterly reports look more consistent. But on the other hand, those reports would be a less accurate reflection of your actual cash flows during the time period.

Rental property numbers are reported on an annual basis, so from a tax perspective you need to pay the most attention to your basis in December and January. Did you pay in December for something that will happen in January or February? In cash basis, that will be reported in the December year, while in accrual basis it would be reported in the January year. Did your tenant pay their January rent early and you got the check in December? That should be reported in the year you received it (December), even if it was 'for' January's rent.

Cash Basis

- Income and expenses recognized when money is exchanged
- Recommended for landlords and simple businesses
- The basis most rental property owners file taxes in

Accrual Basis

- Income and expenses recognized when they occur, not when money changes hands
- Recommended for most traditional businesses

GROSS REVENUES AND EXPENSES VS NET

One general tenet of bookkeeping for tax time is that the IRS requires you to report your gross - meaning total - revenues and expenses. Your gross revenues minus your gross expenses results in your net taxable income, which is the final number that you will end up paying taxes on.

This may sound simple and obvious conceptually, but sometimes it presents an additional bookkeeping challenge. For example, let's say that you utilize a professional property management company for one of your rentals. Every month, your property manager collects rent ($1,000) on your behalf, charges you a management fee ($100), and then sends you the net amount of rent minus management fees ($900).

So what you see in your bank account is the net amount of $900. Many investors will simply record this deposit as $900 of rent revenue for the appropriate property. But what really happened, and what your property management statement reflects, is that you received $1,000 in rent revenue and incurred $100 in management expenses.

This is also the case for many short term rental owners who utilize platforms like Airbnb and VRBO. The STR platform charges you fees that are taken out before the funds get to you, again meaning that you only have the net amount visible in your bank account.

You may be asking yourself - well what's the difference, what's the problem? If the numbers all get to the same place at the end of the day, then there's nothing to worry about, right? Well, as mentioned above, the IRS asks you to report your gross revenues and gross expenses, and not just your net revenues.

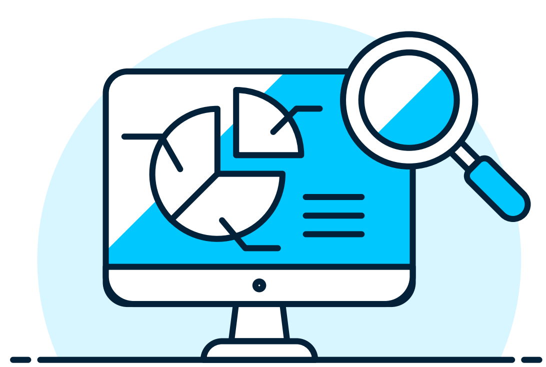
In addition, remember that property managers and short term rental platforms are required to issue 1099s if they collect more than $600 of rental income on your behalf. Those 1099s will report the total amount of revenue collected on your behalf to the IRS. A general tax best practice is to have your self-reported numbers match up as closely as possible with any other data sources the IRS has to reduce the chances of potentially being subjected to an audit.

Realistically, this potential gross vs net revenue discrepancy is likely not material enough to cause big problems or penalties. But it is a dynamic that you should be aware of so that you and your tax preparer can make your own judgements.

So all of the above being said - how can you best get your bookkeeping to reflect gross revenue and expenses, even when you only have the net amount in your bank account? If you are using spreadsheets or generic accounting software, you may need to use multiple transactions or a clearing account to capture all the relevant data.

TurboTenant Accounting offers a few features to make handling net deposits easier. One of our default transaction types is for 'Net Income' that is explicitly designed to allow you to record both revenue and expense lines in one transaction associated with the net bank deposit - making it faster and easier to accurately record this type of transaction.

Additionally, TurboTenant Accounting offers the ability to consume payout statements exported from your Airbnb and VRBO accounts. This allows you to capture all the relevant revenue (daily rent and cleaning charges) and expenses (platform fees, sometimes payment processing) directly from the source!



RECEIPTS AND DOCUMENTATION

Another important thing to consider around tax time is your documentation. While you don't actually submit receipts to the IRS along with your tax return, you need to maintain them in case of audit or inquiry by the IRS. Preparing for taxes is a logical and consistent time to ensure that you have all of your records saved and accessible for the future.

The IRS recommends that you keep your receipts and supporting documentation for at least 3 years, but many accountants and tax preparers suggest maintaining records for 7 years just to be safe and prepared.

In addition to receipts, you should also maintain documentation of property purchases, sales, and major improvements such as closing disclosures and contractor invoices.

For more information on what records you should keep - both financial and operational - read [more here >>]

Some key considerations when bookkeeping for rental property taxes are:

- The classification as passive activity necessitating using the Schedule E
- The per property reporting requirement
- The strong preference for using cash basis accounting
- The IRS's desire for gross numbers instead of net and the centrality of financing and depreciation.

MONEY RECEIVED IN THE COURSE OF YOUR RENTAL OPERATIONS

OK, it is time to dive further into the actual numbers that will comprise your Schedule E, and how you will arrive at them. Starting with the funds you receive in the operation of your rental business, we will look at how they are reported, different kinds of revenue, look at what kinds of funds are not considered revenue, and talk about the difference in recording gross and net numbers in the eyes of the IRS.

RENTS, FEES, AND OTHER REVENUE

The IRS Schedule E form has only one line to report your per-property revenue, called ‘Rents Received.’ Despite the fact that many landlords charge or receive additional income beyond base rent, at tax time everything gets condensed down to one simple line item.

This does not mean that there is no value to tracking the different types of revenue you receive from your tenants or guests. Having additional granularity in your bookkeeping (typically through multiple revenue accounts) can provide meaningful business intelligence and help you better understand your business and make higher quality decisions in the future. But when it comes to tax time- it all goes in the same bucket and on just one line of your Schedule E.

So, what is considered ‘Rents Received’ by the IRS? In short - almost all of the funds you collect should be included. There are a few key exceptions to be aware of which are discussed in the next section below.

For most rental property owners, these funds fall into a few general categories like rents, tenant fees, and variable charges like utilities and cleaning.

Rents

Unsurprisingly, rents are the primary revenue source that will be reported on your taxes. This includes the base rent for long term rentals and the nightly rate for short term rentals. It also includes any additional rent line items beyond the base rent.

The most common additional rent items are monthly charges like parking charges, pet rent, and appliance rentals. If you have consistent, non-variable monthly line items due from your tenants, they would typically be considered additional rents.

Application and Tenant Fees

In addition to the consistent monthly rents, most landlords also charge some one time or infrequent fees to their tenants or guests. These fees are also considered revenue and should be included in the 'Rents Received' line item of your Schedule E.

The most common example is application fees. Most landlords now charge an application fee to cover the costs of screening potential tenants. Even if the prospective tenant does not rent the property, you still need to report the application revenue received from them. If you incurred costs from the screening process, like paying for a background or credit check, you will enter those direct costs as expenses.

Other fees could include things like re-keying a lock if the tenant loses their keys, a repair charge for tenant-caused damage, a one-time pet fee, and so on. If you charge it to your tenant without an expectation of having to return the funds to them, it should be considered revenue and included on your tax return.

Utilities and Cleaning Charges

Recurring but variable charges like utility payments collected from tenants should also be reported as revenue. Even if you are charging the exact amount of the utility bill (such as electric, water, gas, internet, etc.) that you will pay directly, you still need to report the collected funds as revenue. Of course, you should also enter in the utility expense when you directly pay it.

This also applies to cleaning fees or charges collected from short term rental guests. Even if it is a separate line item from the nightly rate, any cleaning fees still need to be reported as revenue and included in your total 'Rents Received' line item on the Schedule E.

Discussed further below, the IRS wants you to report your gross (full) revenues and gross expenses, and let it net out on the Schedule E form. They want you to 'show your work' and provide the full picture. So even if you collect from a tenant an exact amount that you will pay on their behalf, your books and tax filing should show both the inflow and outflow of those funds.

Retained Security Deposits

One source of revenue that many rental property owners often neglect to properly report is retained security deposits. Almost every landlord is very familiar with the concept of security deposits, but do not realize that when you keep some or all of a tenant's security deposit, those funds become revenue that needs to be reported along with your rents, fees, and variable charges in the 'Rents Received' line of the Schedule E.

It is especially easy to miss this, especially because refunding or retaining security deposits happens at the end of tenancy. At this point, there are always many other operational tasks that need urgent attention like move out, making the unit ready for a new occupant, finding and screening new applications, and organizing move in.

Additionally, you generally only retain or keep part or all of the security deposit when there is damage or back rent owed. So there are often real cash flow changes that the retained security deposit helps make you whole for - which makes total sense and is why security deposits exist!

But because the security deposit is not recorded as rent or revenue when you receive it, the funds that you keep must be re-categorized as revenue when the decision is made to retain them.

NOT ALL COLLECTED FUNDS ARE REVENUE

As we just discussed, virtually all of the funds that you collect from your tenants or guests need to be reported as revenue and included in the 'Rents Received' line item, even if they are not explicitly what we typically think of as rent. But there are a few relevant exceptions to this rule.

The most common of these is security deposits. While these are funds collected from the tenant, the money is still considered to belong to the tenant even if you are presently in possession. The expectation is that you will return the security deposit, assuming the tenant does not cause damage and fulfills their rent obligation.

For these reasons, security deposits received from tenants should not be recorded as rent or revenue. This only changes (as mentioned above) when you retain some or all of the deposit for damage or back rent, at which point the retained funds need to be categorized as revenue.

It is also worth noting that this applies only to explicit security deposits. If you collect first months rent, last months rent, and a security deposit from a tenant at move in, the first and last months rent should absolutely and immediately be recorded as rent revenue. There is no expectation of those funds being returned, and cash-basis accounting (see above) dictates that we recognize transactions when money changes hands.

The second major exception applies primarily to short term rental owners. Many municipalities levvy occupancy or hotelier taxes on short term stays. These taxes are on and paid by the guest, not the landlord, and will be paid to the government, not the landlord. Therefore, these taxes are neither a revenue nor an expense to the short term rental owner.

In most areas short term rental platforms like Airbnb and VRBO help facilitate the collection and remittance of these taxes, and so many landlords may never really see or think about them.

However, some municipalities mandate that the property owner receive and remit these taxes instead of the short term rental platform. Some platforms, especially direct booking websites, are not set up to facilitate this process and simply route all funds to the landlord. In these cases, you will receive the tax funds, but should not record them as revenue.

These funds will be held on your books as a liability (similar to a security deposit) which will be relieved when you remit the funds to the municipality. Just as they are not considered revenue when you receive them, you should not consider them expenses when you remit them. You are simply holding the funds for a short time, and they will not affect your taxable income in any way.

A NOTE ON INTEREST

Depending on how your finances are structured and what kind of bank accounts you hold money in, you may also earn interest revenue. While earned interest is indeed considered income, the IRS does not look at it in the same way as the other income you earn in the operation of your rental properties. As such, any interest earned is not reported on your Schedule E. Instead, you will typically report earned interest on the Schedule A instead.

In some states or areas, you may be required to hold security deposits in a trust account and return any earned interest back to the tenant. You should consult the specific tax rules in your locality to ensure you are handling and reporting this accurately.

Money In Summary

The IRS Schedule E has one line to report all your revenues for each property; 'Rents Received.' This should include all the rents, fees, and utilities that you collect from tenants, as well as any retained security deposit funds.

Remember that the IRS wants you to report your total revenues and total expenses, not just the net of your collected funds. Do not include security deposits you are still holding, pass-through occupancy taxes or earned interest.

MONEY SPENT ON YOUR RENTALS

Now that we have looked at the money you receive through a tax-focused lens, it is time to examine the money you spend running your rental property business. Most (but not all) of your costs have some sort of tax impact, so closely tracking your spending is important to ensuring you claim all the deductions you are entitled to.

The vast majority of the money you spend will fall into one of three categories: costs that are deductible when they occur, costs that that need to be capitalized and depreciated over multiple tax years, and costs related to your financing and loans

The first group of costs are what we typically refer to as expenses. Generally speaking, just about all the funds that you spend to manage or maintain your rental properties are deductible expenses that will reduce your net taxable income.

The second bucket of costs are typically referred to as capital expenditures (CapEx) or fixed asset purchases. Generally speaking, these are the funds to acquire, adapt, update, or improve your property.

The third category of costs are your mortgage and loan payments. Financing is tremendously central to rental property investing, and it is important that you properly account for loan payments and their nuances.

We will examine each of these groups in more detail, talk about the nuances of loan payments, and highlight some types of account withdrawals that you should not try and deduct on your taxes.

Deductible	Capitalized and Depreciated	Non-Deductible
Ordinary and necessary expenses	Acquiring new properties	Loan principal repayment
Costs to manage and maintain	Substantial updates and improvements	Internal transfers, like credit card payments
Improvements/asset purchases for operating properties less than $2500	Replacement of whole home systems e.g. roofs	Owner distributions and personal spending

DEDUCTIBLE EXPENSES

The IRS allows rental property owners to deduct 'ordinary and necessary' expenses incurred in the operation of your rentals. Ordinary means that the expenses are typical and widely accepted in the rental industry, and necessary means that the expenses are helpful and appropriate for the continued operation of the business.

This standard is set to ensure that business owners do not deduct costs that are a) not related to operating the business or b) that improve or change the business, and therefore should instead be capitalized and depreciated (discussed in the next section below).

For rental property owners specifically, a good rule of thumb is that any costs that are incurred in the management or maintenance of your rental property business are generally considered deductible expenses. Management and maintenance are broad categories that encompass the operation of your rentals, but also draw a line between upkeeping (deductible) and acquiring or improving (capitalized) costs.

If you are paying someone else to do the work for ordinary and necessary expenses, you can deduct both the labor and materials cost. However, if you are doing the work yourself, the IRS does not allow you to deduct your own labor costs. So if you are DIYing a repair, you can only deduct the cost of materials.

THE SCHEDULE E EXPENSE CATEGORIES

In order to organize your deductible expenses, the IRS provides a set of fifteen expense categories on the Schedule E. All of your deductible expenses need to end up in one of these categories on the Schedule E. Some may not fit perfectly, and that is OK; you can also add line items under the catch-all 'Other' category.

Below, we will list out each expense category and what costs they typically include. For an even more detailed breakdown, **read more about the Schedule E income and expense categories here!**

Advertising

Advertising expenses include any costs that are related to marketing and advertising your rental properties. This can include paying for listing websites and ads, physical marketing like signage, and more. Services with an eye towards marketing, such as professional photography, can also be included in this category.

Auto and Travel

Rental property owners can typically deduct the costs associated with traveling to manage or maintain their properties. However, there is more nuance in the IRS rules regarding travel than most other expenses.

For example, there are two different ways you can claim deductions for auto related costs. You can choose to either use the standard mileage deduction (67 cents per mile in 2024, 70 cents per mile in 2025), or choose to claim your actual expenses (fuel, insurance, repairs, etc) and prorating for the amount of rental business use. Most investors choose the standard mileage deduction due to its simplicity.

For more context, check out our resources on local travel and out of town travel!

Cleaning and Maintenance

Cleaning and Maintenance is a broad category that can include a variety of costs, such as landscaping, pest control, and cleaning the property between tenants.

The Schedule E has a separate category for repairs (below), so it is suggested to differentiate between maintenance costs that keep key systems operational and repair costs where something has ceased to function as intended.

Commissions

Commission costs include referral fees to find tenants. This can include third party property managers who place tenants for you, or even short and medium term rental platforms who charge you fees to find and facilitate the rental process.

Do not include commissions paid to real estate agents related to the purchase of new properties. Those costs are typically capitalized as part of the property purchase and included in your basis.

Insurance

You can deduct your insurance premiums or deductible payments related to your rental properties. This can include homeowner, flood, hazard, or other insurance policies.

Please note that you cannot directly deduct the escrow portion of your monthly mortgage payment. The IRS only allows you to deduct the direct and actual expense where the bill is paid, so you should only enter it after your lender pays the insurance company. Until that time, the funds in escrow still technically belong to you. See the loan payments section below for more context on escrow!

Legal and Professional Fees

If you have paid a lawyer to assist with a lease or an eviction, or paid a CPA or bookkeeper to assist with tax filing or financial management, those costs can be entered in this category.

This category is also often used to enter in software costs, as there is not an explicit category for software. Property management software, accounting software, and rent analysis software are some examples of software that you may use in the operation of your rental business.

Management Fees

Include costs charged by a property manager or management company in this category. The fees charged by short and medium term rental platforms can also be added here.

Mortgage Interest

Most rental property owners finance some or all of their properties through conventional mortgages. The interest on those mortgages is deductible and should be included in this category.

However, the repayment of loan principal is not deductible, so be sure to not enter your entire mortgage payment as a mortgage expense. See the loan payment section below for more information!

Other Interest

Use this category to enter in interest paid to non-mortgage lenders for rental property related purposes. This could include private (not banks) lenders, relatives, and credit card interest.

Repairs

Use this category to report the costs of keeping your property in operating condition. Repair expenses fix issues and correct problems to keep the property functional. Common repair costs include addressing leaky faucets or toilets or fixing a broken step.

Do not include costs to update, remodel, or improve your property in this category. Those costs will need to be capitalized and depreciated, rather than deducted. Read our resource on repairs vs capital improvements for more information.

Supplies

This category can be used for deducting consumables used for your rental properties. This includes office supplies and items like paper towels or complimentary cleaning products for short term rentals.

Taxes

Deduct taxes related to your investment properties here. Do not deduct your income taxes here, as those are not related to your rental business.

Similar to the Insurance section above - you can only deduct your actual taxes paid. If you have an escrowed loan, you will not deduct the monthly escrow transfer amounts, as they are not the actual, direct tax expense paid. See the loan payment section below for more information.

Utilities

If you pay any of the utilities at your rental properties, those costs can be deducted here. If the tenant reimburses you for the utilities, make sure to record those funds as revenue as discussed above.

If the tenant pays the utilities directly themselves, those funds should not be recorded as income or deducted as expenses.

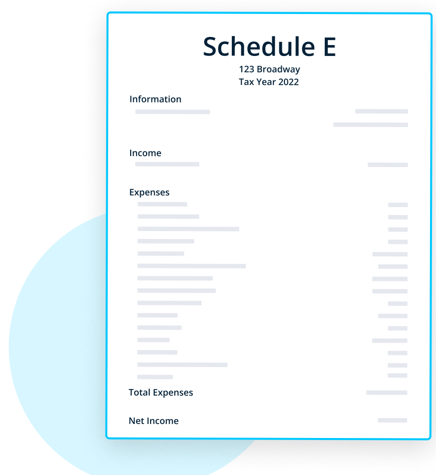
Depreciation Expense or Depletion

Depreciation expenses are how you recover the costs of purchasing, remodeling, or otherwise improving properties. You cannot fully deduct capital improvements like a new roof or HVAC system in the year they are installed, but you can claim a portion of the cost each year as a depreciation expense.

Read on below for more information on fixed assets, capital expenditures, and depreciation.

Other

You can use the Other expense category to record ordinary and necessary expenses that don't cleanly fall into one of the above categories. Common expenses that could fall into the Other category include HOA fees and education costs related to your rental property investments.



WHAT IF YOU WANT MORE DETAILED EXPENSE TRACKING?

In order to prepare for tax time, you don't need to go any deeper or more granular than the categories provided by the IRS. All of your expenses need to fit into one of the above categories, so it makes sense to start with the Schedule E defaults.

But what if you want more information, more business intelligence, out of your bookkeeping? Broad categories like Cleaning and Maintenance or Utilities can encompass a great deal of spending in a variety of ways. Perhaps you'd like to know how much you spent on turnover cleanings vs HVAC maintenance, or how much you spent on electricity vs gas.

To accomplish this and get more value out of your bookkeeping, most accounting softwares allow you to create sub-accounts beneath an existing expense account (for example, create Electricity and Gas sub-accounts beneath the Utilities account) Setting up your expense accounts in this way allows you to track your costs in a more detailed fashion, while still being able to easily see the totals at tax time.

TurboTenant Accounting's default expense categories are an exact match to the IRS Schedule E - making the distance between keeping your books and getting ready for tax time as short as possible.

If you want more detail out of your bookkeeping, you can easily update your chart of accounts with new categories and subaccounts as desired!

FIXED ASSETS, CAPITAL EXPENDITURES, AND DEPRECIATION

Fixed assets and capital expenditures are a big part of rental property accounting and tax preparation. These are your depreciable items; primarily the property itself and the capital improvements you make to it.

The IRS considers these costs to be investments in your business, and therefore are not operational expenses that can be deducted against rental income in a single year. Instead, your costs are recouped over a preset period of time through depreciation expenses.

They are called ‘fixed’ assets because they are essential to business operation and are not expected or intended to be sold in the short term. Fixed assets are the trackable item on your balance sheet, capital expenditures (or fixed asset purchases) are the individual transactions that collectively set the balance of the fixed asset, and depreciation is the mechanism by which you recover your investment costs. The value of an asset on your balance is sheet is called its ‘basis.’

Each fixed asset has a placed in service date (when the property is listed for rent or the improvement work is completed), a property it is associated with, an asset type, and a useful life that is defined by the asset type. Fixed assets can have a depreciable and a non-depreciable basis. Collectively, these factors determine the amount of depreciation that can be taken in a given year and over how many years it will be depreciated.

You can have more than one fixed asset per property. The property itself is one, and then each additional improvement project that is completed while the property is in service needs to be tracked as its own asset. You don’t just keep adding new expenditures to existing assets - when the project is done and placed in service the asset is ‘closed’ and you begin taking depreciation against it.

The exception is improvements, renovations, or remodeling after purchasing a property but before placing it in service - those costs are typically considered part of your initial investment and are included with the property basis.

THE PROPERTY ASSET

Each of your investment properties are fixed assets that will be depreciated. The standard useful life for residential property is 27.5 years, meaning you will have depreciation expenses for 28 years, if you hold the property for that long. The first year and last year of ownership will have pro-rated depreciation entries; the other years will all be the same amount.

The depreciable basis of your rental property is not the same thing as the purchase price. This is for two primary reasons.

First, the majority of properties have both a depreciable basis and a non-depreciable basis. This is because in addition to the building or structure value, there is also land value and land is not depreciable. Your tax assessment typical reflects both the buildings, structures, or improvements value (depreciable) and the land value (non-depreciable).

Second, some of the closing costs associated with purchasing an investment property should be capitalized and included in the depreciable basis. This includes items like title fees, surveys, recording fees and legal costs. Other closing costs, like property taxes and prepaid mortgage interest, can be expensed.

Many rental property investors have their CPA, tax preparer, or tax preparation software handle setting the property's basis based on the closing statement.

Click here to learn more about how to analyze the closing statement to set the property basis and create a journal entry.

Did you know?

For a $500k house with a $400k depreciable basis, the annual depreciation amount is $14,545.45! What a deduction!

IMPROVEMENTS

Each of the capital improvements you make at your in-service rental property also need to be tracked as a fixed asset and depreciated over time. Capital improvements are the larger projects that improve or update the property, or replace whole-home systems. Read our reference on fixed assets vs repairs for more context on how to determine how your costs should be handled.

These improvements should be tracked on a per-project basis, as different projects typically are completed at different times, and depending on the project, may have different useful lifetimes. Click here to learn more about different asset types and how many years they should be depreciated over.

Each fixed asset or project may be comprised of any number of transactions. If you paid a contractor to do the work, you may just have one or two transactions. If you did the work yourself, you may have 50-100 transactions for all the different times you had to run to the home improvement store. Either way, the transactions are aggregated under the fixed asset and depreciated as a whole.

Generally speaking, the longer you own your property, the more fixed assets you will be tracking. It is the sum of the depreciation amount of each of the fixed assets tied to a property that is reported on the IRS Schedule E in the Depreciation expense category.

Expenses		CapEx
• Ordinary and necessary costs to manage or maintain • Deducted against income in the year they occur • Ex. repairs, maintenance, taxes, insurance, interest, etc.	VS	• Adds value or extends the useful life of the property • Capitalized and depreciated over time • Ex. bathroom or kitchen remodel, new roof or HVAC

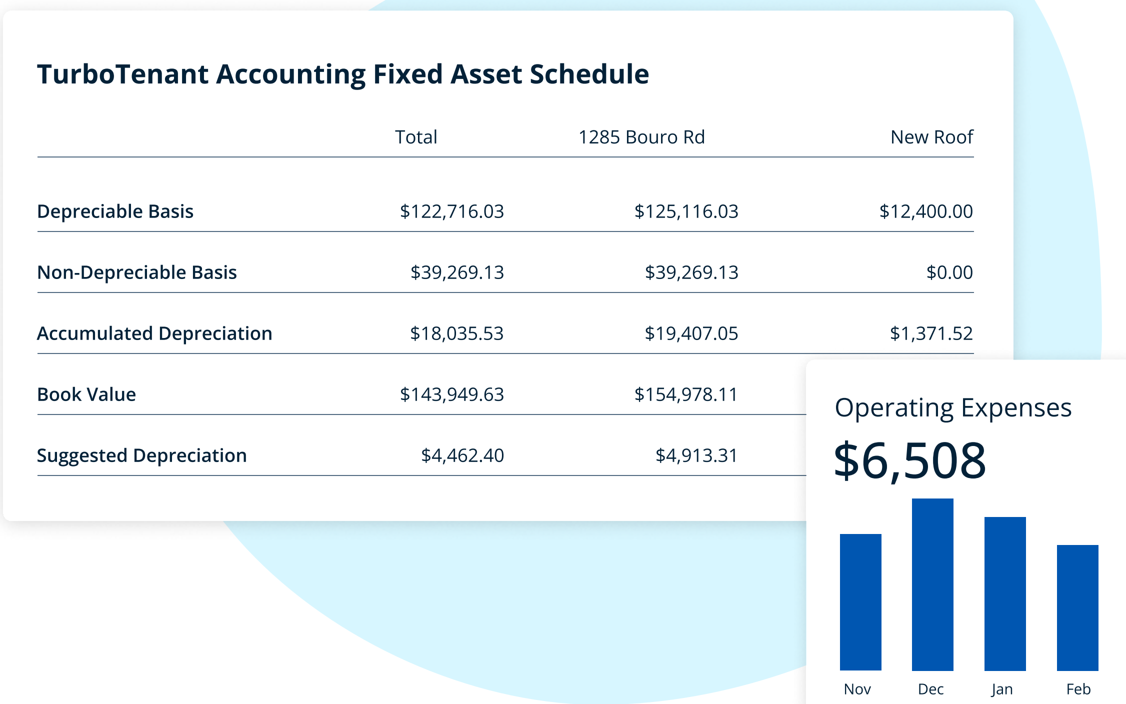
THE DE MINIMIS ELECTION

There is one big threshold to be aware of when deciding whether to treat some purchases as expenses or capital expenditures. The IRS provides a de minimis safe harbor that allows you to expense items under $2,500 that would otherwise be considered a fixed asset.

This is incredibly helpful for most investors, as it increases the amount you can deduct against your revenue in the current tax year, and it decreases the amount of individual fixed assets you need to track and depreciate over time.

So when a dishwasher goes out and needs to be replaced- as long as it's under $2,500, you don't need to worry about capitalizing it and depreciating it over 5 years. You can simply treat it as an expense instead.

Do please note that the de minimis election is only available for currently operating properties. If you are renovating a property after purchasing it but before listing it for rent, you will still need to capitalize all of those improvement costs.



MORTGAGE AND LOAN PAYMENTS

Financing plays a huge role in real estate investment, and therefore properly accounting for loan payments is uniquely important for rental property owners. For the vast majority of investors, scaling your portfolio means buying more properties using more loans.

Loans and loan payments, whether they are considered mortgages or not, are not simply deductible expenses. Although each loan payment is a single amount, they are actually comprised of two or three different types of transactions from an accounting perspective.

Principal

First, most loan payments include principal pay down. This is the part of the payment that is directly paying down the loan balance that you owe. Principal re-payment is NOT tax deductible, and should not be included on your Schedule E.

Paying down principal is moving money from one of your assets (bank account) to one of your liabilities (loan), making it a transfer and therefore not considered an expense. Essentially, you are converting cash into home equity.

Interest

The interest you pay as part of your financing for your rentals IS considered an expense and is tax-deductible.

If your loan is a traditional mortgage with a bank, it should be reported on the Mortgage Interest line of the Schedule E. If it is a non-bank loan or for something other than a property, the interest expense should be added to the Other Interest line.

In some situations, you may have loan payments that are comprised entirely of interest, with no principal component. In that circumstance, the entire loan payment could be entered as an expense.

Did you know?
TurboTenant Accounting's loan payment template feature makes it easy to automatically break your mortgage or loan payment down into it's principal, interest, and escrow components making your books more accurate and tax time easier than ever!

Escrow

In addition to principal and interest, some mortgage payments also include an escrow portion. Some lenders protect their investment by requiring an escrow account to be used for paying annual property tax and insurance expenses.

The escrow account is still your funds, even if it is held by the lender. That means that the monthly portion of your loan payment that goes to escrow is not considered an expense and therefore is not tax deductible. It is a transfer from one account you own (your bank) to another account you technically own (the escrow account), and not a direct payment for either taxes or insurance.

When the lender pays the tax and insurance bills out of the escrow accounts, you absolutely can and should claim those costs as deductible expenses. Because it was paid out of your funds (even if facilitated by the lender) and went directly to the government or insurance company, this is the transaction that the IRS wants you to record on your taxes.

Always double check your reports at tax time to make sure you have entered in your tax and insurance expenses if you have an escrowed loan. Because these transactions don’t hit your regular operating bank account like almost everything else, they can be easy to miss!

How to Track Principal, Interest, and Escrow

There are a few ways to accurately track your principal, interest, and escrow for tax time. First, you can break down each loan payment into their component pieces.

This is easy with real estate accounting software, but a more manual process in a generic software or spreadsheet. If your software can’t dynamically calculate the changing principal and interest amounts of each loan payment, you will need to reference your loan statement or amortization table to get the correct values.

Second, you can wait until (typically in January) your lender sends you 1098 statements that show how much you have paid in interest in the previous calendar year. This lets you get to the deductible interest amount quickly, but does mean that your rental property books will be less accurate during the tax year.

OTHER WITHDRAWALS

There are a few other common situations where money moves out of your rental bank accounts, but the funds should not be treated as a deductible expense or capital expenditure.

In order to keep your bookkeeping accurate and your risk of audit low, make sure that you are correctly classifying the below.

Credit Card Payments

When you pay your credit card bill, you are moving money from one account you control (your bank account asset) to another account you control (your credit card account liability). Your credit card payment is reducing the balance owed on your credit card, but itself is not a direct expense. For these reasons, your credit card payments are not allowable deductible expenses.

The individual charges on your credit card where you purchased an item or paid for a service - those are the direct expenses that you can deduct on your Schedule E!

Security Deposit Refunds

Returning a security deposit to a departing tenant should not be classified as an expense. It was not revenue when you collected it - it was the tenant's money that you were holding onto - and so is also not an expense when you return it.

Internal Transfers

When you move money from one of your accounts to another, you are simply making an internal transfer. This type of transaction should not be reported as an expense of any kind and will not impact your tax filing.

Personal Spending or Distributions

Funds moved from a rental bank account to a personal bank account, or spent for personal use, are not deductible expenses. In either case, you are simply moving money from inside the business to outside of it. These transactions are typically categorized as owner distributions.

MONEY OUT SUMMARY

Almost all of the funds you spend on your rental properties will impact your taxes - but not always in the same way.

Generally, the money you spend to manage and maintain your rentals is deductible in the year it was spent against your rental income. These ordinary and necessary expenses should be categorized according to the IRS Schedule E.

Funds spent to acquire a rental property, or to substantively improve, update, or adapt it, should be capitalized and depreciated over the asset's useful life. Each fixed asset (the property, each discrete improvement project) is depreciated individually and contributes to the total depreciation expense amount entered on the Schedule E.

Loan payments are comprised of principal repayment, interest, and (if applicable) escrow transfer. Principal repayment is not deductible in any way. Interest is deductible as an expense. Escrow is not directly deductible, but the actual property tax and insurance expenses are deductible.

Credit card payments, internal transfers, and owner distributions (or personal spending out of rental accounts) are not taxable events and should not be deducted.

REVIEW AND TAX PREP

After you have entered in all your income and accounted for everything you've spent - is it time to send everything off to your CPA and the IRS?

Not quite! It is always a best practice to double-check for easily missed transactions and deductions and review your reports before completing your Schedule E or sending it on to your accountant.

We've highlighted most of the below items earlier in this guide, but these are some of the top errors in bookkeeping for rental property tax prep. It is easiest to miss the potential deductions that don't show up in your operating bank accounts!

DID YOU BOOK ALL RENTAL-RELATED TRANSACTIONS FOR THE TAX YEAR?

This sounds obvious - but it is so important it is worth being sure. It can be surprisingly easy to forget about an expense, neglect to include it in your records, and end up paying more in tax than you should have as a result. It is especially easy if you are not utilizing accounting software and a dedicated account for your rentals!

It is even easier to accidentally omit anything you may have paid out of pocket or from a personal bank account. Even if you have a dedicated account, it is still possible to grab the wrong card by mistake. So if you pay for something out of a non-rental account - make sure you add it to your records as soon as possible so you don't forget!

So it is always recommended to take the time and make sure you have all your data. If you are using accounting software, make sure all your transactions are booked and categorized correctly. If they are un-booked and not categorized, they are not yet a part of your financial records!

DID YOU (OR WILL YOUR TAX PREPARER) ENTER DEPRECIATION DEDUCTIONS?

As we saw above, depreciation is how investors recover the costs of buying and improving rental properties. It is a tax deduction only and not a direct financial expense, meaning that it won't appear in your bank account and therefore can be easy to miss.

Depreciation deductions are highly impactful and it is important they be included in your taxes. Frequently, they are substantial enough for a rental property to be cash-flow positive but show a loss on taxes.

Despite their importance and impact, some investors choose to outsource tracking fixed assets and depreciation schedules to their CPA or tax preparer due to the higher level of complexity and understanding required.

Regardless of whether you are managing your fixed assets and depreciation yourself in your accounting software or tax preparation software, or are relying on your financial professional, you need to have a clear understanding of who is responsible for calculating and entering annual depreciation on your Schedule E.

DID YOU RECORD ANY MILES DRIVEN TO MANAGE OR MAINTAIN YOUR PROPERTIES?

The IRS allows rental property owners to deduct miles driven while maintaining or managing their properties. Because this is an operational tax deduction without a direct expense hitting your bank account, it is an easy omission for many investors.

If you utilize a professional property manager, you may not have any mileage deductions to claim. But if you directly manage or maintain your rentals, odds are you have the ability to deduct some mileage!

To learn more and see if you can deduct your miles or trips, check out our resources on local travel and out of town travel!

DID YOU MAKE SURE TO ONLY ENTER LOAN INTEREST AS AN EXPENSE?

Your entire loan payment is not tax deductible - only the interest amount is. Double check your transactions in the 'Mortgage Interest' and 'Other Interest' categories to confirm that you are only claiming the interest portion of your payments as deductible expenses.

INVESTORS WITH ESCROWED MORTGAGES: DID YOU ENTER PROPERTY TAX AND PROPERTY INSURANCE EXPENSES?

As discussed above, you cannot deduct your monthly escrow transfers, as they are not direct expenses. But you absolutely should be deducting the actual amounts of the property tax and insurance expenses paid out of your escrow account.

Because these expenses are paid out of your escrow account by your lender on your behalf, you will not have an imported transaction from your operating bank account to prompt you to book them. So, if you have an escrowed mortgage, don't forget to book those annual property taxes and insurance expenses!

REVIEWING REPORTS

Now that you are sure you have entered all of your transactions, it is time to review your reports and make sure that they are reflecting what really happened in the last tax year. Do your numbers match expectation? Does any total stick out as a bit odd or unusual?

For example, you might look at your property by property totals and ask yourself questions like:

- Is the total rent for the property approximately 12x the total monthly charges? If not, was the property vacant for part of the year?
- Do the expense totals match my expectations? Does something seem way higher - or way lower - than it should be?
- Is the Repairs category unusually high? Should a project that you included in Repairs actually have been recorded as a capital improvement and depreciated?

If you are unsure of any of your totals, go back to the individual transactions as the primary source. Look and see if there are any gaps or periods where you may be missing data, or for any potential duplication.

Reports and totals can help you spot discrepancies and errors, but they are derived directly from the individual transactions that collectively form your financial records.

PREPARING THE SCHEDULE E

If you are using spreadsheets or standard accounting software, you are probably able to generate a basic Profit and Loss or Net Income statement. This core financial report lists your income on top, your expenses below, and the net (income minus expenses) number at the bottom.

This will get you close, but not all the way, to looking like and including everything that goes on the Schedule E tax form. To go from a standard P&L to a Schedule E, you need to:

- Ensure that your expense categories match the Schedule E. Minimize expenses assigned to the 'Other' category as much as possible.
- Add your mileage deductions into the 'Auto & Travel' expense category. The IRS mileage rate for 2024 is 67 cents per mile.
- Enter in depreciation expenses for each property. If you are depreciating capital improvements in addition to the property, make sure the total depreciation entry includes the amounts from the capital projects as well.
- Prorate overhead transactions that apply to all your properties down to the property level. Alternatively, split each overhead transaction into the per-property amount.

From there, you are ready to pass your information along to your CPA, tax preparer, or tax preparation software! Congratulations on making it through another tax season!

Want to hit the easy button? TurboTenant Accounting's built-in Schedule E report automatically:

- Consolidates your expense accounts to the Schedule E categories
- Includes mileage deductions from any trips entered into the TurboTenant Accounting mileage log
- Prorates your portfolio-level transactions across each of your properties

Need other reports? Using TurboTenant Accounting, you can also produce:

- Balance Sheets
- Form 8825 for Partnerships
- Fixed Asset Schedules
- And many more!

ABOUT TURBOTENANT ACCOUNTING

TurboTenant Accounting makes and supports accounting software for rental property owners and real estate investors. TurboTenant Accounting's mission is to make investment property bookkeeping easier, more efficient, and less stressful.

Property Based Accounting

Property by property tracking makes it easier to keep your books, understand your numbers, and get ready for tax time in a flash!

Preset for Rentals

Rental-specific transaction types to help you keep your books easier and an investor focused (and editable) chart of accounts help you get started faster and keep more accurate books than ever before.

Automate Your Bookkeeping

Link your bank and credit card accounts to automatically import transaction data, and use transaction matching rules to put your bookkeeping on auto-pilot!

Advanced Accounting Features

Use the loan payment template to see your principal, interest, and escrow splits automatically and fixed asset tracking to categorize capital expenditures, basis, and depreciation.

Built in Schedule E Report

TurboTenant Accounting's intelligent Schedule E report helps you go from a traditional profit and loss statement to a tax ready form in record time!

Helpful Customer Service

Have questions? Our friendly and knowledge customer support team is happy to help you get up in TurboTenant Accounting the right way and make sure you are confident in your bookkeeping.