

Sy Accountancy Corporation

Member, American Institute of CPAs

704 Mira Monte Place, Pasadena, California 91101

Tel (626) 744-0200 • Fax (626) 744-0300 • vsy@victorsycpa.com • www.victorsycpa.com

REPAIRS AND MAINTENANCE ON RENTAL PROPERTY - DEDUCT OR CAPITALIZE?

By Victor Sy, CPA, MBA

The deduction of losses from rental properties is usually an issue questioned by an IRS auditor. A taxpayer wants to deduct as soon as possible; the auditor wants to capitalize and spread the deduction over many years.

Let's review some guidelines on [when to deduct, when to capitalize](#).

1. **Repairs** are expenses to keep your property in good condition. It does not materially add to the value of your property or substantially prolong its life (painting, window screens, broken windows, mending leaks, plastering).
2. **Improvements** add to the value of your property and prolong its useful life or adopt it to new uses (new roof, room addition, new plumbing, fence, new cabinets, driveway).
3. **Replacements** are capitalized when they stop deterioration and add to the life of the property. Replacements are expensed if they only keep it in normal operating condition.
4. **Repairs are deductible when paid; improvements are capitalized and depreciated.** (TIP: If you have repairs or improvements near the end of 2010, pay some in 2011, and the remainder in 2010. Big amounts stick out as red flags for capitalization).
5. **Residential** buildings are **depreciated** over 27-1/2 years, commercial buildings over 39 years. These rules apply regardless of the age of the building. A brand new apartment is depreciated over 27-1/2 years. A 50-year old apartment is also depreciated over the same 27-1/2 years. Let us assume further that you have a rental house that you have had for five years and has 13 years remaining (18 years total under previous ACRS rules). A new roof would be depreciated over 27-1/2 years!
6. **Commercial** buildings are depreciated over 39 years.
7. In addition to repairs, you may deduct **ordinary and necessary expenses** for your rental property such as mortgage interest, real estate taxes, advertising, gardening services, utilities, and fire insurance.
8. **Advance rentals** (last month's rental deposit) are taxable in the year received.
9. **A new IRS letter** ruling states that costs of restoring business property to its pre-casualty condition can be deducted as repairs if they are incurred to put the property back to its pre-casualty condition and do not materially enhance the value, use, or life expectancy of the damaged property.
10. **New proposed regulations** may limit certain expenses. As you know, whether a cash outlay is a deductible expense or capital improvement is a constant issue between taxpayers and the IRS. In an effort to eliminate this controversy, the Service has issued proposed regs to **cap repairs based on percentage of cost**. Excess over the annual cap must be capitalized. The regs are rather lengthy and further complicates what is already a complicated tax system. We'll attempt to discuss the new repair allowance methods in future articles.

Update: California liberalized rules on [tax withholding on the sale of real estate](#). For most sales of property other than a principal residence, California **withholds 3 1/3% of the sales price**. For Sales occurring after January 1, 2007, a new law allows the seller the option of having withholding taken at the rate of 9.3% of the estimated tax gain.