State and Local Taxes on Residential Rental Properties

Using Washington, DC Taxes as an Example

Residential rental properties often create complicated tax issues at the federal, state, and local levels. Although there are numerous federal tax issues to consider, this article attempts to clarify the myriad of state and local tax issues that arise when a taxpayer rents a residential property. While this article uses the District of Columbia as an example, we recommend you check the six items below no matter where your rental property is located. We do not discuss here the numerous tax issues that arise when a residential property is sold, disposed, or transferred. This article is also limited to rental properties owned by individuals and operating as sole proprietorships. There are other matters that come into play for rental properties owned by entities. Lastly, the items below generally apply to both long-term and short-term rentals.

Please consult your tax advisor for specific details applicable to your case.

1. Initial Business Registration

Many jurisdictions around the U.S. require the formal registration of businesses operating within their state, county and/or city, even if the business is not formally incorporated.

In DC, all owners of new businesses, including rental properties and sole proprietorships, are required to fill-out DC Form FR-500 and file this form with the DC Office of Tax and Revenue at inception.

2. Business License

A business license of some type is also required to be maintained in many parts of the country. Depending where you are located, the business license may be known as a lodging or operating permit. The license is frequently required to be displayed for guests to see, and is usually renewed annually. Further, for multiple units or properties, you may be able to obtain just one license for your city or county, where other jurisdictions require a license by location.

For DC, a business license must be maintained for rental properties of all types by location. The license is obtained from the DC Department of Regulatory and Consumer Affairs and renews bi-annually.

3. Annual Income or Franchise Tax Filings

Most states (and some counties and cities) tax net income from rental activities. A few jurisdictions tax gross receipts on rental activities. Where net income from rental activities is taxed, many jurisdictions follow reporting from the federal income tax return – Schedule E for individuals. However, it is important to note that many state and local jurisdictions do not conform to the federal rules, particularly in the areas of deductible expenses and depreciation expense. Some states allow taxpayers to file a resident or non-resident income tax return (this is dependent on the taxpayer's status in the state or jurisdiction) to report the rental property activity. Some states (and some counties and cities) require the taxpayer to file a separate franchise tax return to report the rental activity.

DC requires taxpayers who own one or more rental properties (and/or other reportable unincorporated business activity) located in DC with combined gross receipts of more than $12,000 to file an annual Unincorporated Business Franchise Tax Return on Form D-30. Taxpayers who are required to file an income tax return on Form D-40 must still separately report their rental property and other reportable unincorporated business activity on Form D-30 if their combined gross receipts exceed the $12,000 threshold for the tax year. Generally, for calendar year filers, all DC taxes must be paid by April 15 of the following year, so for larger rental properties and unincorporated businesses, estimated tax payments may be required. The Form D-30 has a $250 minimum filing fee that must be paid annually by April 15 either with Form D-30 or with an extension for filing Form D-30 (on Form FR-130). A 6 month extension to file Form D-30 is granted after filing the extension form to October 15 (7 months to November 15 for combined reporting).

4. Real Property Taxes and the Homestead Exemption

Many jurisdictions around the country assess real estate taxes based on the current valuation of real property, frequently upon land and building values. Also, many jurisdictions offer a homestead exemption discount toward real property taxes when the homeowner is domiciled in the same state as the property location and the property is used as the homeowner's primary residence.

DC allows a homestead exemption only for taxpayers' domiciled in DC and who live in the property as their primary residence. A taxpayer domiciled in DC who converts the property to a rental property must remember to turn off the homestead exemption or DC will assess penalties and interest for under-paid real estate taxes. Taxpayers who are not domiciled in DC but own a property in DC that they use as their primary residence or rent to a third party are not permitted to claim the DC homestead exemption. You can check or change the status of the homestead exemption on your DC property by using an internet search for "DC Real Estate Tax Assessment" and then type in the property address to locate your property's tax assessment record.

5. Personal Property Taxes

Many taxing authorities also assess property taxes on tangible personal property located within their boundaries and used in a trade or business, including personal property used at rental properties. Items of personal property are often considered as anything moveable, such as furnishings, equipment, and supplies. The rules regarding the assessment of personal property taxes vary greatly across the country, so once again, we urge rental property owners to check their local rules.

For DC, rental property owners and businesses are exempt from paying personal property tax if the aggregate cost or current value of all such property is $225,000 or less as of July 1. However, DC property owners are still required to file a personal property tax return annually on Form FP-31. DC's definition of taxable personal property includes such things as books, reference materials, libraries stored electronically, unregistered vehicles, and trailers, in addition to furniture, fixtures, equipment and supplies. The DC personal property tax return is filed annually on Form FP-31 and is due by July 31. Filing of the Form FP-31 may be extended by 3 months after filing Form 129-A requesting the extension.

6. Sales, Use and/or Lodging Taxes

Sales taxes, use taxes, and lodging taxes are borne by the final consumer of the service or product - the renter or lessee in this context. At last count, there are over 15,000 sales tax jurisdictions around the country, each with their own rules, making compliance somewhat difficult. For owners of rental properties, sales tax, use tax, and lodging tax compliance is almost always based on the location of the property. Using the property location, sales, use, and lodging tax regulations and rates are generally available through an internet search. Sales and lodging taxes are generally applied to the daily, weekly or monthly rate using the local applicable percentage. Use tax is sometimes applicable to rental property owners for materials, goods, and supplies that are untaxed and brought in from another jurisdiction.

Sometimes sales and lodging taxes refer to the same tax, while in other cases sales and lodging taxes are different, and multiple such taxes could apply. We have seen properties where four distinct sales/lodging taxes are applicable. For short-term and Airbnb rentals, it is particularly important that owners understand sales, use, andlodging tax rules and exactly who will register, collect, and pay each tax.

Lastly, and perhaps most importantly, owners of long-term residential rentals are often not required to charge sales or lodging taxes. In some cases, long-term is defined as more than 90 days, in others it is 180 days, and others it’s 183 days, so again it is important to know the local rules.

For properties located in DC, sales taxes are not applicable for rentals of 91 days or more as determined at inception of the rental period. DC applies a 14.5% rate to charges for rooms, lodgings, furnished accommodations and other short-term rentalproperties furnished to transients. DC sales and use tax returns are filed either monthly, quarterly or annually of Form FR-800.

DC charges use tax on the consumption, storage, or use of taxable tangible personal property and services within DC that have not been previously taxed. The use tax rates follow the sales tax rates, which is currently 6% for most items, 9% for sales of alcoholic beverages to be consumed off-premises, and 10% for food and drink served on-premises.

Once again, please consult your tax advisor for tax matters applicable to your specific circumstances.

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