Repairs vs. Improvements – What Can I Deduct from my Taxes?

Having to make repairs to my rental properties can be expensive.

Knowing that I can deduct this expense from my taxes makes it a little easier to swallow.

The general rule is that the cost of "repairs" incurred to maintain your rental properties may be deducted from each property's taxable income in a given year. However, some repairs are considered "improvements" in which you're not allowed to deduct the entire expense immediately.

Repairs vs. improvements, so what's the difference?

Repairs

Repairs are usually one-off fixes that help keep the property in good working condition and habitable. Although the price is irrelevant, most of my qualifying repairs tend to be under $500 in cost.

Whether you're fixing a hole in the wall, or an unclogging a shower drain, you can deduct the cost of these minor repairs from the current year's tax liability.

The IRS clarifies in the 1040 Schedule E Instructions that "*repairs in most cases do not add significant value to the property or extend its life.*"

Improvements

Anything that increases the value of the property or extends its life is categorized as a "capital expense" and must be capitalized and depreciated over multiple years. Meaning, you can only deduct a small but even portion of these expenses in the current tax year.

Improvements, such as replacing a roof or renovating a kitchen, are usually more labor-intensive than repairs and typically cost substantially more.

The good rule of thumb is that if you are adding a new item, or upgrading an existing item, then it's usually considered an improvement.

The assumption is that these improvements will add value to the property over multiple years, not just the current year – and thus why you can't deduct the entire $20k kitchen renovation in a single year.

Likewise, when you sell a property, you'll need to know the costs of these improvements and how much each one has been depreciated because you will have to pay taxes on the depreciated amount. This should be easy to track if you keep accurate records/receipts and copies of tax returns.

Types of Capital Expenses

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The IRS uses the following categories to help define a capital expense. You are required to capitalize and depreciate the following:

- **Improvements.** You must capitalize any expense you pay to improve your rental property. An expense is for an improvement if it results in a betterment to your property, restores your property, or adapts your property to a new or different use.
- **Betterments.** Expenses that may result in a 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 expenses for replacing a substantial structural part of your property, repairing damage to your property after you properly adjusted the basis of your property because of a casualty loss, or rebuilding your property to a like-new condition.
- **Adaptation.** Expenses 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.

Source: IRS Rental Income and Expenses

Comparison of Repairs and Improvements

Repairs	Improvements
Repairing a cracked foundation	Adding a structural addition, extra rooms, garage, etc.
Repairing a broken AC fan, replacing damaged/clogged air vent registers or air filters	Adding central air conditioning
Replacing a broken security camera	Installing a security system
Replacing a small area of carpet that was damaged, or having it professionally cleaned	Installing brand new carpet
Patching a leaky or damaged roof	Replacing an entire roof
Replacing a broken plumbing pipe, leaky faucet, or running toilet	Replacing all existing plumbing
Replacing an unsafe or improperly run section of electric wire, outlet, or light fixture	Replacing all existing electric wiring

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Repairs	Improvements
Replacing a broken cabinet	Renovating a kitchen
Refinishing or resurfacing the wood floors, or replacing damaged planks	Replacing the wood floors
General painting	Painting as part of a larger restoration project or addition
Fixing appliances	Replacing appliances (fridge, stove, washer/dryer)
Replacing a broken door knob	Replacing all the door hardware in the house for cosmetic reasons
Replacing a few cracked tiles	Tiling the entire bathroom floor
Replacing the glass in a window frame	Replacing multiple windows (entire house)

Finally, Official Guidance

As of January 1, 2014, the IRS has released official guidance regarding deduction and capitalization of expenditures related to tangible property, which add to and clarify the existing understanding of deductible repairs and depreciable improvements mentioned above.

Examples of Improvements

According to the IRS, the addition or upgrade of the following items must definitively be capitalized and depreciated over multiple years.

Heating & Air Conditioning

- Heating system
- Central air conditioning
- Furnace
- Duct work
- Central humidifier
- Filtration system

Lawn & Grounds

- Landscaping

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- Driveway
- Walkway
- Fence
- Retaining wall
- Sprinkler system
- Swimming pool

Miscellaneous

- Storm windows, doors
- New roof
- Central vacuum
- Wiring upgrades
- Satellite dish
- Security system
- Attic, Wall, Floor Insulation

Additions

- Bedroom
- Bathroom
- Deck
- Garage
- Porch / Patio

Plumbing

- Septic system
- Water heater
- Soft water system
- Filtration system

Interior Improvements

- Built-in appliances
- Kitchen modernization
- Flooring
- Wall-to-wall carpeting

Source: https://www.landlordology.com/repairs-vs-improvements-tax-deductions/

Information provided courtesy of Mir Taxes LLC

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Written on February 19, 2014 by Lucas Hall, updated on September 27, 2017