INTERNAL REVENUE SERVICE

IRS Fact Sheet

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Deducting Rent and Lease Expenses

FS-2007-14, February 2007

The Internal Revenue Service reminds taxpayers to follow specific guidelines when deducting rent and lease expenses incurred as part of a trade or business.

In order to educate taxpayers regarding their filing obligations, this fact sheet, the ninth in a series, explains the rules for deducting these expenses. Rent and lease expenses account for just part of the overstated adjustments, deductions, exemptions and credits that add up to $30 billion per year in unpaid taxes, according to IRS estimates.

In general, taxpayers may deduct ordinary and necessary expenses for renting or leasing property used in a trade or business. An ordinary expense is an expense that is common and accepted in the taxpayer's trade or business. A necessary expense is one that is appropriate for the business.

Rented or leased property includes real estate, machinery, and other items that a taxpayer uses in his or her business and does not own. Payments for the use of this property may be deducted as long as they are reasonable. However, special rules and limitations apply to business use of the taxpayer's rented personal residence and leased automobiles. More information on these topics is in Publication 587, Business Use of Your Home and Publication 463, Travel, Entertainment, Gift, and Car Expenses.

Conditional Sales Contract

Sometimes payments are listed as "rent" when in reality they are actually for the purchase of the property. A conditional sales contract generally exists when at least part of the payments are applied toward the purchase or entitle the taxpayer to acquire the property under advantageous terms. Payments made under a conditional sales contract are not deductible as rent expense but qualify for depreciation expense over the useful life of the asset. Chapter 4 of Publication 535, Business Expenses, discusses the circumstances under which a conditional sales contract generally exists.

Capitalizing Rent Expenses

Under certain conditions taxpayers who are in the business of producing real property or tangible personal property for resale, or who purchase property for resale, may not claim rental or lease expenses as a current deduction. Instead, they must include some or all of these costs in the basis of the property they produce or acquire for resale under the uniform capitalization rules. These costs are recovered when the property is sold. More information on this topic is in Publication 538, Accounting Periods and Methods.

Business and Personal Use

If a taxpayer has both business and personal use of rented or leased property he or she may deduct only the amount used for business. To compute the business percentage, compare the size of the property used for business to the entire size of the property. Use the resulting percentage to figure the business portion of the rent expense. Two commonly used methods for figuring the percentage are:

- Divide the area (length multiplied by width) used for business by the total area of the property.

- If the rooms in the property are all about the same size, divide the number of rooms used for business by the total number of rooms.

Further Information

Further information on this subject is available in the following IRS publications:

- Publication 535, Business Expenses
- Publication 587, Business Use of Your Home
- Publication 463, Travel, Entertainment, Gift, and Car Expenses
- Publication 538, Accounting Periods and Methods

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