

Short-Term Rental, Special Treatment

Article Highlights:

- Airbnb, VRBO, and HomeAway
- Rented for Fewer than 15 Days During the Year
- The 7-day and 30-day Rules
- Exceptions to the 30-Day Rule
- Schedule C Reporting

If you are one of the many taxpayers who rents out a first or second home using rental agents or online rental services (such as Airbnb, VRBO and HomeAway) that match property owners with prospective renters, then some special tax rules may apply to you.

These special (and sometimes complex) taxation rules can make the rents that you charge tax-free. However, other situations may force your rental income and expenses to be treated as a business reported on a Schedule C, as opposed to a rental activity reported on Schedule E.

The following is a synopsis of the rules governing short-term rentals.

Rented for Fewer than 15 Days During the Year – When a property is rented for fewer than 15 days during the tax year, the rental income is not reportable, and the expenses associated with that rental are not deductible. Interest and property taxes are not prorated, and the full amounts of the qualified mortgage interest and property taxes are reported as itemized deductions (as usual) on the taxpayer's Schedule A.

The 7-Day and 30-Day Rules – Rentals are generally passive activities. However, an activity is not treated as a rental if either of these statements applies:

- A. The **average** customer use of the property is for 7 days or fewer—or for 30 days or fewer if the owner (or someone on the owner's behalf) provides significant personal services.
- B. The owner (or someone on the owner's behalf) provides extraordinary personal services without regard to the property's average period of customer use.

If the activity is not treated as a rental, then it will be treated as a trade or business, and the income and expenses, including prorated interest and taxes, will be reported on Schedule C. IRS Publication 527 states: "If you provide substantial services that are primarily for your tenant's convenience, such as regular cleaning, changing linen, or maid service, you report your rental income and expenses on Schedule C." Substantial services do not include the furnishing of heat and light, the cleaning of public areas, the collecting of trash, and such.

Exception to the 30-Day Rule – If the personal services provided are similar to those that generally are provided in connection with long-term rentals of high-grade commercial or residential real property (such as public area cleaning and trash collection), and if the rental also includes maid and linen services that cost less than 10% of the rental fee, then the personal services are neither significant nor extraordinary for the purposes of the 30-day rule.

Profits & Losses on Schedule C – Profit from a rental activity is not subject to self-employment tax, but a profitable rental activity that is reported as a business on Schedule C is subject to this tax. A loss from this type of activity is still treated as a passive-activity loss unless the taxpayer meets the material participation test – generally, providing 500 or more hours of personal services during the year or qualifying as a real estate professional. Losses from passive activities are deductible only up to the passive income amount, but unused losses can be carried forward to future years. A special allowance for real-estate rental activities with active participation permits a loss against nonpassive income of up to \$25,000 – phasing out when modified adjusted gross income is between \$100K and \$150K. However, this allowance does **NOT** apply when the activity is reported on Schedule C.

These rules can be complicated; please call this office to determine how they apply to your particular circumstances and what actions you can take to minimize tax liability and maximize tax benefits from your rental activities.