



DID YOU KNOW?

Did you know you may be able to deduct losses from your short-term rental property against your W-2 income?

Is it generally understood, subject to very limited exceptions, losses from real estate rentals are passive activity losses and are not deductible against an individual's active income from a business or wages. As a practical matter, such losses can only be so deducted by someone who performs (i) more than 50% of their services during the year in real property businesses and (ii) more than 750 hours of services during the year in such business ("real estate professional").

The increasing popularity of short-term rentals has made an exception to the foregoing rule more relevant than it has been historically. This limitation does not apply to losses from rentals where the average period of customer use is seven days or less (e.g. Airbnb) and does not include rentals where the average period of customer use is 30 days or less and significant personal services are provided in connection with the rental. Significant personal services are the type of services one would expect to receive at a hotel.

Since these types of rentals are not treated as rental activity, you only need to demonstrate that you "materially participate" in the activity. There are seven ways you can do that. At the low end of the scale, if you participate in the rental activity for more than 100 hours during the year, and your participation is not less than any other person (including employees/contractors), you meet the test. This material participation test requires approximately two hours of participation per week during the year, as opposed to 15 hours per week to be a real estate professional. An additional benefit of establishing material participation is that the income from the rental activity will not be subject to the 3.8% net investment income tax.

Bottom Line: It can be much easier to deduct losses from short-term rentals than under the general rule.

Advisory: That condo in Vail or on the beach that you are now thinking of buying, can only be used personally for less than the greater of 14 days or 10% of the total days rented without blowing the losses.

"Always borrow money from a pessimist. He won't expect it back." – Oscar Wild



[James E. Duffy](mailto:JDuffy@Taftlaw.com) / (612) 977-8626 / JDuffy@Taftlaw.com