



Many taxpayers will rent their first or second homes using rental agents or online rental services that match property owners with prospective renters, such as Airbnb, VRBO and HomeAway. When a taxpayer rents property for a short period, special (and sometimes complex) taxation rules come into play, which can make the rents excludable from taxation; other situations may force the rental income and expenses to be reported on Schedule C (as opposed to 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 (IRC Section 280A(g)), and the expenses associated with that rental are not deductible. Interest and property taxes are not prorated, and the full amount of the qualified mortgage interest and property taxes are reported on the taxpayer's Schedule A.

*The 7-Day and 30-Day Rules:* Rentals are generally passive activities. However, an activity is NOT a rental activity if (Reg Sec 1.469-1T(e)(ii)):

1. 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.
2. The owner (or someone on the owner's behalf) provides extraordinary personal services without regard to the property's average period of customer use.

Since the activity is a trade or business that is not classified as a rental for Schedule E purposes, the only other option is to report the income and expenses on Schedule C. That opinion is shared by IRS Publication 527, which 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, trash collection, and such. Thus, the rental income and expenses, including interest and taxes, are included on Schedule C.

**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 the cleaning of public areas and trash collection), and if the rental also includes maid and linen services, the cost of which is less than 10% of the rental fee, then the personal services are neither significant nor extraordinary for the purposes of the 30-day rule (Reg. 1.469-1T(e)(3)(viii), Example 4).

**Profits & Losses on Schedule C** – Profit from a rental activity that is reported on Schedule E is not subject to self-employment (SE) tax, but a profitable rental activity reported on Schedule C is subject

to SE tax. A loss from this type of activity is still treated as a passive activity loss and thus is limited under Sec 469 unless the taxpayer meets the material participation test or follows the real estate professional rules. Note that the special allowance for rental real estate activities with active participation, which permits a loss against nonpassive income of up to \$25,000 (phasing out when modified adjusted gross income (MAGI) is between \$100K and \$150K), does **NOT** apply when the activity is reported on Schedule C (Form 8582, Worksheet 3 and instructions).

July 20, 2016 by Lee Reams Sr.

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