PacificCPE

Short-Term Vacation Rental Taxation Part 2

Course #3292A

Taxes

2 Credit Hours

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SHORT-TERM VACATION RENTAL TAXATION PART 2

This course covers the day-to-day operating expenses incurred from a short-term rental and what expenses qualify as current. It also covers repairs, betterments, improvements, and how depreciation is handled.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

Operating Expenses
Repairs
Deducting Long-Term Assets

Study the course materials from pages 1 to 51

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- To recognize what expenses qualify as current
- To differentiate repairs, betterments, and improvements
- To recognize how depreciation is handled

NOTICE

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EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.

- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.

- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.

- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.

- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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CHAPTER 1: OPERATING EXPENSES

This chapter is about the day-to-day operating expenses you incur for your short-term rental activity. All these expenses are currently deductible in the year they're incurred (except for start-up expenses). Some are deductible in full; others must be allocated according to how much and how long you rent your property.

WHAT ARE OPERATING EXPENSES?

You may start to deduct your operating expenses the moment your short-term rental activity begins—this ordinarily happens when you list your property for short-term rental. Expenses you incur before you offer your property for rent are not operating expenses but may be deductible as start-up expenses (see "Start-Up Expenses," below). Many different types of operating expenses exist—so many that they can't all be individually listed in the tax law. The basic rule is that you can deduct in a single year any expense that is:

- ordinary and necessary
- current
- directly related to your rental activity, and
- reasonable in amount. (I.R.C. § 162.)

An expense is ordinary and necessary if it is common, helpful, and appropriate for your activity. It doesn't have to be indispensable—it only has to help your rental activity in some way, even a minor way. A one-time expenditure can be ordinary and necessary. Generally, the IRS won't second guess your claim that an expense is ordinary and necessary unless the item or service clearly has no legitimate business purpose. You will not be allowed to deduct off-the-wall or clearly ridiculous expenses.

An expense is current if it is for an item that will benefit your rental activity for less than one year. These expenses are the costs of keeping your rental venture going on a day-to-day basis, including money you spend on items or services that get used up, wear out, or become obsolete in less than one year. A good example of a current expense is the cost of utilities like electricity, gas, and water you provide your short-term guests. Anything you purchase that will benefit your rental activity for more than one year is not a current expense—for example, purchasing a new refrigerator for your vacation home. You can usually deduct the cost of personal property like a refrigerator in a single year using bonus depreciation or the de minimis safe harbor (see Chapter 3).

An expenditure must be directly related to your rental activity to be deductible as an operating expense. So, you can't deduct personal expenses. If you buy something for both personal and rental use, you can deduct only the business portion of the expense. You must figure out how much of the time you use the item for rental purposes and how much for personal purposes. You then allocate the total cost between the two purposes and deduct only the rental portion of the cost. These allocation rules are particularly important for part-time rentals and are discussed in detail in course 3293A.

Finally, unreasonable expenses aren't deductible. As a rule of thumb, an expense is reasonable unless more economical and practical ways are available to achieve the same result. If the IRS finds that your deductions are unreasonably large, it will disallow them or at least disallow the portion it finds unreasonable. Certain areas are hot buttons for the IRS—especially travel and meal expenses. The IRS won't allow any lavish expenses here, and you will have to follow strict rules requiring you to fully document these deductions.

DIRECT EXPENSES DEDUCTIBLE IN FULL

Any operating expense you incur solely for your short-term rental activity is deductible in full. These are expenses you incur only because you're renting your property short term; otherwise, you wouldn't have them, including all the following types of expenses.

Rental Platform Fees and Commissions

The fees charged by short-term rental platforms, such as Airbnb, VRBO, or FlipKey, are all fully deductible operating expenses. These fees can be substantial, so this deduction can be valuable. For example, Airbnb charges a "host service fee" equal to 3% of the cost of each reservation (but some hosts pay more), while VRBO charges $499 for an annual subscription. These rental platforms also typically charge "service fees" to guests—for example, Airbnb charges guests a 13%–20% service fee. Obviously, hosts can't deduct guest fees because they don't pay them. Guests might be able to deduct such fees if their travel is for business.

Local and State Licenses and Fees

Many local (and some state) governments require short-term hosts to pay for business licenses and special registration fees. For example, San Francisco requires short-term hosts to pay a $250 registration fee every two years. These fees are fully deductible operating expenses.

Advertising and Marketing Expenses

Expenses you incur to advertise and market your short-term rental are fully deductible. For example, if you hire a professional photographer to take pictures of your property for your online rental listing, the cost is fully deductible. The same goes for hiring a copywriter to help you write the description of your property for your listing. If you create your own website to market your short-term rental, the cost is also deductible. Ongoing website hosting, maintenance, and updating costs are currently deductible operating expenses. Money you spend to get people to view your website, such as SEO (search engine optimization) campaigns, is also currently deductible. However, the cost of initially developing your website may constitute a capital expense, not a currently deductible business operating expense. If so, the cost may have to be deducted over three years. Any other advertising you do is also deductible.

Car and Local Transportation Expenses

Local travel is travel by car or other means within the area of your tax home—the entire city or general area where you live. If the home you rent out short term is also the main home where you live, this deduction might be quite limited. You might have more deductions if you have a second home you rent out, but even here, restrictions are in place.

Driving Must Be for Rental Activity

You may deduct local travel only if it's for your short-term rental activity. For example, you can deduct the cost of driving to the airport to pick up or drop off your short-term guests. You can also deduct driving to meet with repair people, attorneys, accountants, property managers, and other people who help in your short-term rental activity.

What about travel to and from your short-term rental property? If this property is also your main home (that is, the place where you live), you'll likely have no deductions for this unless you have an office outside your home you use to manage your rental activity (which is rare for short-term rental hosts). In this event, you could deduct travel between your outside office and your main home for rental purposes.

You'll likely qualify for more deductible local travel expenses if you rent out a property other than your main home, such as a vacation home. Travel from your main home to your vacation home (or other property away from your own home) can be deductible if done for rental purposes—for example, to do cleanup, maintenance, repairs, guest check-in, hauling supplies, or other rental-related tasks. However, this is true only if you have an office in your main home that qualifies as the principal place of business for your rental activity (see "Home Office Deduction," below). Otherwise, such trips are nondeductible personal commuting, even if there is a rental purpose for the trip. Moreover, you may not currently deduct driving expenses incurred while making improvements to your home or another property you use in your short-term rental activity. Instead, the cost of such driving must be added to the basis (cost) of the improvement and depreciated over several years (see Chapter 2).

How to Deduct Car Expenses

If you have tax-deductible driving expenses, you may deduct them by using the standard mileage rate or the actual expense method. With the standard mileage rate, you deduct a specified number of cents for every business mile you drive. The IRS sets the standard mileage rate each year. Usually, one standard rate applies to the whole year. But due to rapidly rising inflation, two rates are in effect for 2022. For January 1, 2022 through June 30, 2022, the standard mileage rate is 58.5¢ per mile. For July 1, 2022 through December 31, 2022, the rate is 62.5¢ per mile. To figure out your deduction, simply multiply your rental miles by the applicable standard mileage rate. You can find the current standard mileage rate on the IRS website. Alternatively, instead of using the standard mileage rate, you can deduct the actual cost of using your car for your rental activity. This requires more record keeping, but it can result in a larger deduction. If you use this method, you must keep careful track of all the costs you incur for your car during the year, including:

- gas and oil
- repairs and maintenance
- depreciation of your original vehicle and improvements
- license and registration fees
- parking fees for rental-related trips, and
- insurance and auto club dues.