



Short-Term Vacation Rental Taxation Part 3

Course #3293A

Taxes

2 Credit Hours

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SHORT-TERM VACATION RENTAL TAXATION PART 3

This course explains how pass-through deductions are handled, which expenses can be prorated, and how to file a schedule E.

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

The Pass-Through Tax Deduction
Prorating Your Deductions
Reporting Rental Income on Your Tax Return
Filing IRS Form 1099 Information Returns
Deducting Losses for Short-Term Rentals
Record Keeping

Study the course materials from pages 1 to 65

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- To recognize how pass-through deductions are handled
- To identify which expenses can be prorated
- To recognize how to file a Schedule E
- To recognize how to file a Form 1099-NEC
- To identify how to handle deduction on multiple properties
- To recognize how to track income and expenses

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: THE PASS-THROUGH TAX DEDUCTION

The Tax Cuts and Jobs Act established a brand-new income tax deduction for owners of pass-through businesses, which includes most short-term rental hosts. This is commonly referred to as the “pass-through deduction” or “qualified business income (QBI) deduction.” If you qualify, you might be able to deduct from your income taxes up to 20% of your net income from your short-term rental business, reducing your effective income tax rate on such income by 20%. This deduction began in 2018 and is scheduled to last through 2025. Following are the basic requirements short-term hosts must satisfy to qualify for this complex deduction. The deduction is available for all types of pass-through businesses, but this chapter focuses on how it works for short-term rental hosts.

YOUR RENTAL ACTIVITY MUST BE A BUSINESS

To qualify for the pass-through deduction, your short-term rental activity must qualify as a business for tax purposes, not an investment activity or not-for-profit activity. This is determined under the general rules used to determine whether any activity is a business. (I.R.C. § 162; IRS Reg. 1.199A-1(b)(14).) These rules are discussed in detail in course 3291.

As discussed in course 3291, most short-term rental activities should qualify as a business, particularly if they earn profits most years. However, hosts who rent their property at below market rates or make no effort to rent it at all are likely to run afoul of this requirement.

The rules for determining whether an activity qualifies as a business are somewhat vague and ambiguous. To provide landlords with absolute certainty, the IRS created an optional safe harbor rule. Under this rule, landlords are automatically deemed to be in business solely for purposes of the pass-through deduction if they:

- perform a total of 250 hours of real estate rental services each year (including work performed by employees and agents)
- keep records documenting the real estate services performed, and
- keep separate books and records showing income and expenses for each rental real estate enterprise. (IRS Notice 2019-7.)

But you can’t use this safe harbor rule if the property involved is used as a residence for tax purposes (as defined in I.R.C. § 280A, which is covered in course 3291). So, you can’t use the safe harbor if you or family members live in the property more than 14 days during the year or if you use it more than 10% of the number of days during the year the property is rented for a fair rental. This limitation eliminates many short-term rental hosts.

If you do live in a property less than 14 days, you can take advantage of the safe harbor rule. But you likely don’t need it. And, remember, its use is purely optional.

YOUR RENTAL ACTIVITY MUST BE A PASS-THROUGH BUSINESS

You have to have a pass-through business to qualify for this deduction. A pass-through business is one in which the profits (or losses) are passed through the business and the owners pay tax on the money on their individual tax returns at their individual tax rates. Luckily, virtually all short-term hosts operate as pass-through businesses. Most short-term hosts own their property individually, as a joint tenancy with their spouse, or with one or more individuals as tenants in common. All these ownership forms qualify as pass-through businesses.

A minority of short-term hosts own the property they rent through a business entity, usually a limited liability company (LLC) or partnership. These also qualify as pass-through businesses. S corporations also qualify but are rarely used for rental property. Regular C corporations don't qualify for the pass-through deduction, but for a variety of tax reasons, C corporations are almost never used for rental property.

YOU MUST HAVE QUALIFIED BUSINESS INCOME

Hosts may qualify to deduct from their income tax up to 20% of their “qualified business income” (QBI). QBI is the net income (profit) your short-term rental business earns during the year. You determine this by subtracting all your regular short-term rental deductions from your total short-term rental income. Your net rental income or loss is listed in the “Total rental real estate and royalty income (or loss)” line at the bottom of Schedule E.

QBI does not include:

- short-term or long-term capital gain or loss—for example, the capital gain (or loss) earned from selling your property
- dividend income or interest income
- guaranteed payments to partners in partnerships or LLC members, or
- business income earned outside of the United States, such as property outside the United States you rent to short-term guests.

You can benefit from the pass-through deduction only if your short-term rental business earns a profit for the year. You get no deduction if your rental business shows a net loss, because your QBI will be zero.

Example 1



Ann rents her home to short-term guests. This year, her guests paid her \$12,000 in rent and she incurred \$6,000 in total deductible expenses, including depreciation. Her QBI is \$6,000.

Example 2

EXAMPLE

Bill owns a main home and a vacation home that he rents to short-term guests. This year, the short-term rental of his main home earned a profit of \$10,000, while the rental of the vacation home incurred a loss of \$4,000. His QBI for his short-term rental business is \$6,000.

If you have other nonrental businesses, QBI is determined separately for each separate business you own. If one or more of your businesses lose money, you deduct the loss from the QBI from your profitable businesses. If you have a “qualified business loss”—that is, your net QBI is zero or less—you get no pass-through deduction for the year. Any loss is carried forward to the next year, and the pass-through deduction for that year (or the next future year with positive QBI) is reduced (but not below zero) by 20% of the loss.

Example

EXAMPLE

During 2022, George earned \$20,000 in QBI from his short-term rental business and had a \$50,000 loss from his Bitcoin mining business. He had a \$30,000 qualified business loss, so he gets no pass-through deduction for 2022, and his loss must be carried forward to 2023. His pass-through deduction for 2023 must be reduced by 20% of his \$30,000 loss, or \$6,000.

YOU MUST HAVE TAXABLE INCOME

To determine your pass-through deduction, you must first figure your total taxable income for the year (not counting the pass-through deduction). This amount is your total taxable income from all sources (short-term rental and other business, investment, and job income) minus deductions, including the standard deduction (\$12,950 for singles and \$25,900 for marrieds filing jointly in 2022) or your itemized deductions. However, you do not include net capital gains for the year in your taxable income (such amounts already receive preferential tax treatment). If you’re married and file jointly, include your spouse’s income in your taxable income.

Your pass-through deduction can never exceed 20% of your taxable income. This limitation won’t adversely impact most hosts because they typically have income in addition to that earned through the short-term rental activity.