Short-Term Rental Depreciation Considerations for Owners

Explore short-term rental depreciation options to develop a real-estate tax-saving plan for yourself or your business.

Short-Term Rental Depreciation

LONG BEACH, CA, UNITED STATES, July 7, 2022 /EINPresswire.com/ -- Owners of real estate investment properties often use a tax strategy involving depreciation deductions to maximize savings on taxes. They use this to recover some of the cost of their real estate investment property's purchase price by claiming depreciation deductions on income tax.

Investors with short-term rental properties can also use depreciation deductions to recoup the cost of their real estate; however, short-term rental depreciation rules differ from the traditional tax strategy.

What Does the IRS Consider Short Term Rentals?

Before enacting a rental depreciation strategy, work with a real estate accounting team to determine if the IRS considers the property a short-term rental. Short-term rental properties generally follow the "vacation home rules," assuming the taxpayer is also using the property for personal purposes which exceed the greater of:

- 14 days per year
- 10% of the total days it was rented to others

Typically, a short-term rental is a first or second home in which the owners use online rental services or rental agents to rent out the property. In the past, these properties were usually limited to beach houses or mountain homes. Now, they may also include properties used as Airbnb or VRBO rentals.

Short Term Rental Depreciation Considerations

When determining a depreciation strategy for a rental property, there are several considerations regarding the eligibility and classification of the property. One needs to consider various depreciation deduction methods to maximize savings on taxes.

First, understand the IRS's eligibility requirements for depreciation deduction properties. The IRS states that eligible properties must:

- Be owned by the individual
- Be used in an income-producing or business activity
- Have a finite useful life – meaning it will wear out after a predictable period
- Have a lifespan of at least one year
- Cannot be classified as excepted property, for example, intangible property

If the property is eligible to use depreciation deductions per IRS criteria, consider short-term rental depreciation specifics. These can include determining deductions, whether one needs to file self-employment taxes, and whether there is earned passive or active activity. Each of these elements affects the tax strategy used to file.

Self-Employment Tax

When owning a short-term rental, determine whether business ownership that is subject to self-employment tax may affect tax-savings opportunities. If a rental yields rental income, file a Schedule E. If the rental income qualifies as business income, file a Schedule C, which is subject to self-employment tax.

The way to determine a classification is by looking at whether substantial services are provided. For example, if one maintains standard services on the rentals, such as internet, heating, AC, and cleaning between guests, the short-term rental income classifies as regular rental income.

Alternatively, if substantial services are provided, like meals, entertainment, transportation, and concierge services, income must be filed as business income, subject to self-employment tax.

Figuring Depreciation

To figure depreciation on a short-term rental property, determine if the rental is a residential or non-residential building. Residential properties depreciate over 27.5 years, while non-residential properties depreciate over 39 years.

If the short-term rental only averages 30 days or less as an average rent period, it would classify as transient. It is therefore classified as a commercial property and depreciates over 39 years.

Another element determining depreciation is separating the land associated with the property versus the building. The IRS does not consider land depreciable, so reflect this by only figuring depreciation for the value of the building and other depreciable items.

The depreciation deduction is further carved into deductible amounts based on space rented as a percentage of total space and the number of days rented as a percentage of total days of use.

Passive Investments

Determining passive versus nonpassive activity also affects a depreciation deduction strategy. Most rental activity is considered passive, which means one can only deduct an amount up to the passive income level. There are exceptions to this rule when:

- One qualifies as a real estate professional per the IRS guidelines, and
- One demonstrates material participation

In some cases, the IRS does not consider the activity to be a rental activity, therefore there is only a need to demonstrate material participation when:

- The average rental is less than 7 days
- The average period of rental is 30 days or less, and substantial personal services are provided

To demonstrate material participation, the IRS holds several standards that must be met. These include:

- Participation in the activity for over 500 hours during the year
- The activity substantially makes up all of the participation in that activity
- One participates in over 100 hours during the tax year, and the activity is not less than any other person's

If these exceptions to passive activity loss limitations are not met, passive rental losses can be deducted against nonpassive income up to $25,000 when the modified adjusted gross income (MAGI) is less than $100,000.

Qualified Improvement Property (QIP)

In 2017, the Tax Cuts and Jobs Act created a class of property called a Qualified Improvement Property (QIP). QIP refers to non-structural upgrades to the commercial property's interior after placing the property in service.

If a short-term rental is a transient or commercial property, and the interior of the building is improved, one may qualify for accelerated depreciation under QIP. This property class has a shorter depreciable life and allows for claiming bonus depreciation in the taxable year the property is placed into service.

Cost Segregation Strategies

As a short-term property owner, consider cost segregation strategies to maximize savings opportunities as well. Cost segregation allows one to take eligible depreciation deductions on the property assets that depreciate more quickly than the rest of the property.

Maximize Tax Savings With Professional Real Estate Accounting Services

To maximize tax-saving opportunities on a short-term rental property, work with a real estate tax professional.

Craig Ima
Windes
+1 562-304-1329
email us here
Visit us on social media:
Facebook
Twitter
LinkedIn
