PacificCPE

COURSE
33703C

Short-Term Rentals: Pass-Through Deductions and Income Reporting

Navigating the pass-through deduction and properly allocating expenses between personal and rental use are two of the trickier challenges in short-term rental taxation. This course covers the Section 199A deduction as it applies to rental activity, explains proration methods for mixed-use properties, and walks through how to correctly report rental income on a tax return. Ideal for practitioners who want to ensure their clients are reporting accurately and capturing every available deduction.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

Start Course ↓ | Final Exam Copy ↓

LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize how pass-through deductions are handled.
- Identify which expenses can be prorated.
- Recognize how to file a Schedule E.

Copyright Notice

© 2026 Pacific CPE, LP. All rights reserved.

The materials in this course — including the text, illustrations, exhibits, examples, exam questions, and review questions — are the copyrighted property of Pacific CPE, LP. No portion of this course may be reproduced, stored in a retrieval system, distributed, or transmitted in any form or by any means (electronic, mechanical, photocopying, recording, or otherwise) without the prior written permission of Pacific CPE, LP, except for the personal, non-commercial use of the registered learner.

Pacific CPE, LP grants the registered learner a single-seat, non-transferable license to access this course for the purpose of completing the associated continuing professional education credit. Account credentials may not be shared. Group access requires a separate enterprise license.

This course is provided "as is" for educational purposes. While Pacific CPE, LP makes a reasonable effort to ensure the content is current and accurate, the materials should not be relied upon as a substitute for professional advice. Pacific CPE, LP disclaims all liability for any error, omission, or loss arising from the use of, or reliance on, the course content.

Questions about reproduction, licensing, or use of these materials should be directed to support@pacificcpe.com.

Publication Date: April 2026

TABLE OF CONTENTS

CHAPTER 01

The Pass-Through Tax Deduction 6

1.01 Your Rental Activity Must Be A Business 6

1.02 Your Rental Activity Must Be A Pass-Through Business 7

1.03 You Must Have Qualified Business Income 7

1.04 Calculating Your Pass-Through Deduction 9

1.05 Taking The Pass-Through Deduction 13

1.06 Strategies To Maximize The Pass-Through Deduction 13

CHAPTER 02

Prorating Your Deductions 16

2.01 Direct Expenses Are Fully Deductible 16

2.02 Expenses That Must Be Prorated 17

2.03 Calculating Personal And Rental Days 20

CHAPTER 03

Reporting Rental Income On Your Tax Return 24

3.01 Most Hosts Use Schedule E To Report Rental Income 24

3.02 Schedule E Line By Line 25

3.03 Schedule E (Form 1040)—Page 1 27

3.04 Completing Schedule E When You Have A Rental Loss 33

3.05 Worksheet 5-1, From IRS Publication 527, Residential Rental Property. 35

Test Your Knowledge 42

Final Exam Copy 65
Glossary 52
Index .....

Chapter 1: THE PASS-THROUGH TAX DEDUCTION

Chapter Objective

After completing this course, you should be able to:

- Recognize how pass-through deductions are handled.
- Identify which expenses can be prorated.
- Recognize how to file a Schedule E.

The Tax Cuts and Jobs Act established a brand-new income tax deduction for owners of pass-through businesses (the OBBBA made this permanent), 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 was made permanent in 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 a 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 Chapter 3 of course 33701D.

As discussed in Chapter 3 of course 33701D, 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 Chapter 2 of course 33701D). 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 doesn't 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

Ana 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

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

During 2025, 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 2025, and his loss must be carried forward to 2026.His pass-through deduction for 2026 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 ($15,000 for singles and $30,000 for marrieds filing jointly in 2025) ($16,100 for singles and $32,200 for married filing jointly in 2026) 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.

Example

For 2025, Larson earned $10,000 in profit from his short-term rental business this year. He had $90,000 in job income and took the standard deduction. His taxable income is $85,400 ($100,000 – $14,600 standard deduction = $85,400). His pass-through deduction can'texceed20%×$85,400=$17,080. Hispass-through deduction is $2,000 (20% × $10,000), so the limit has no practical effect.

CALCULATING YOUR PASS-THROUGH DEDUCTION

How you calculate the pass-through deduction depends on your annual taxable income. The rules differ for 2025 taxable income:

- Up to $197,300 ($394,600 if married)
- Between $197,300 to $247,300 ($394,600–$494,600 if married), and
- Above $247,300 ($494,600 if married).

For 2026, the phaseout range expands, increasing from $50,000 to $75,000 for singles and $100,000 to $150,000 if married).

Taxable Income Up to $197,300 ($394,600 If Married)

If your 2025 taxable income is at or below $197,300 if single, or $394,600 if married filing jointly, your pass-through deduction is equal to 20% of your qualified business income (QBI). However, as discussed above, the deduction may not exceed 20% of your taxable income.

Example

For 2025, Tom is single and earned $10,950 in QBI during 2025 from his short-term rental business. He also earned $103,650 in job income and took the $14,600 standard deduction. His total taxable income for the year is $100,000 ($10,950 + $103,650 – $14,600 = $100,000). His pass-through deduction is 20% × $10,950 = $2,190. He may deduct $2,190 from his income taxes.

If your taxable income is at or below the $197,300/$394,600 for 2025 threshold, that's all there is to the pass-through deduction. You're effectively taxed on only 80% of your short-term rental business income.

Taxable Income Above $247,300 ($494,600 If Married)

If your 2025 taxable income is above $247,300 (single) or $494,600 (married filing jointly), your maximum possible pass-through deduction is 20% of your QBI, just like at the lower income levels. However, when your income is this high, a W-2 wage/business property limitation takes effect. Your deduction is limited to the greater of:

- 50% of your pro rata share of W-2 employee wages paid by your rental business, or
- 25% of W-2 wages plus 2.5% of the acquisition cost of the depreciable property used in your short-term rental business.

Few short-term rental hosts have employees. They manage their short-term rental businesses themselves or hire property management companies who are not W-2 employees. So they have zero wages upon which to base their pass-through deduction. Fortunately, the pass-through deduction may alternatively be based on 2.5% of the acquisition cost of your depreciable property plus 25% of W-2 wages (which will likely be zero).