PacificCPE

COURSE
34306B

Landlords: Travel, Hired Help, and Casualty Loss Deductions

Rental property ownership often involves long-distance travel, payments to workers, and the occasional unexpected loss — each of which can generate meaningful deductions when handled correctly. This course covers the tax rules for deducting travel expenses tied to rental activity, the requirements for properly classifying and paying employees and independent contractors, and how casualty and theft losses are treated in a rental context. Tax professionals will leave with practical knowledge to guide landlord clients through each of these distinct deduction areas.

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

Start Course ↓ | Final Exam Copy ↓

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 what travel expenses are deductible.
- Recognize what payroll expenses are deductible.
- Identify the tax implications of hiring independent contractors and employees.
- Recall the limitations related to the casualty and theft deduction.
- Recognize how casualty gains are taxed.

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TABLE OF CONTENTS

CHAPTER 01

Travel Expenses 6

1.01 What Are Travel Expenses? 6

1.02 Deductible Travel Expenses 10

1.03 How Much You Can Deduct 12

Test Your Knowledge 16

CHAPTER 02

Hiring Help 19

2.01 Deducting Payments To Workers 19

2.02 Employees Vs. Independent Contractors 22

2.03 Tax Rules When Hiring Independent Contractors 24

2.04 Tax Rules For Employees 31

2.05 Hiring Your Family 34

2.06 Hiring A Resident Manager 37

Test Your Knowledge 40

CHAPTER 03

Casualty And Theft Losses 45

3.01 What Is A Casualty? 45

3.02 Calculating A Casualty Loss Deduction 47

3.03 Federally Declared Disaster Area Losses 53

3.04 Casualty Gains 54

3.05 Repair And Replacement Costs For Casualty Losses 54
3.06 Tax Reporting And Recordkeeping For Casualty Losses 55
Test Your Knowledge 57

Final Exam Copy 63
Glossary 61
Index .....

Chapter 1: TRAVEL EXPENSES

Chapter Objective

After completing this chapter, you should be able to:

- Recognize what travel expenses are deductible.

If you travel overnight for your rental activity, you can deduct your airfare, hotel bills, meals, and other expenses.

If you plan your trip carefully, you can even mix landlord business with pleasure and still take a deduction.

However, IRS auditors closely scrutinize deductions for overnight travel and many taxpayers get caught claiming these deductions without proper records to back them up.

To stay within the law (and avoid unwanted attention from the IRS), you need to know how this deduction works and how to properly document your travel expenses.

WHAT ARE TRAVEL EXPENSES?

For tax purposes, "travel expenses" are the amounts you spend when you travel away from your tax home overnight for your business (rental) activity. You don't have to travel any set distance to take a travel expense deduction. But you can't take this deduction if you just spend the night in a motel across town. You must travel outside your city limits. If you don't live in a city, you must go outside the general area where your tax home is located.

You must stay away overnight or at least long enough to require a stop for sleep or rest. You can't satisfy the rest requirement by merely napping in your car.

Example

Phoebe lives in Los Angeles. She flies to San Francisco to deal with a repair problem in a rental house she owns there. She spends the night in a hotel, and returns home the following day. Her trip is a deductible travel expense.

If you don't stay overnight, your trip won't qualify as travel. But you might still be able to take a tax deduction. Local trips for your rental activity are also deductible (see Chapter 1 of course 34306C), but you're entitled to deduct only your transportation expenses—the cost of driving or using some

other means of transportation. You may not deduct meals or other expenses like you can when you travel and stay overnight.

Example

Philip drives from his home in Los Angeles to San Diego to show his rental property to prospective tenants and returns home that same day. His 200-mile round trip is a deductible local trip. He may deduct his expenses for the 200 miles he drove, but he can't deduct the breakfast he bought on the way to San Diego.

Related Topic

How to deduct local travel. For a detailed discussion of tax deductions for local travel, see Chapter 1 of course 34306C.

Where Is Your Tax Home?

Your "tax home" is the entire city or general area where your principal place of business for your rental activity is located. If you run your rental activity out of your residence, your tax home is the city or area where you live.

The IRS doesn't care how far you travel for business. You'll get a deduction as long as you travel outside your tax home's city limits and stay overnight. So, even if you're just traveling across town, you'll qualify for a deduction if you manage to stay outside your city limits.

Example

Pete's tax home is in San Francisco. He drives to Oakland to check up on an apartment building he owns. He decides to spend the night in an Oakland hotel rather than brave the traffic back to San Francisco. Pete's stay qualifies as a deductible travel expense even though the distance between San Francisco and Oakland is only eight miles. Pete can deduct his hotel and meal expenses.

If you don't live in a city, your tax home covers the general area where you typically reside—the area within about 40 miles of your home.

Your Trip Must Be for Rental Business

To deduct the cost of your trip, it must be primarily for your rental activity. So, you must have a rental purpose in mind before starting out, and you must actually do something for your rental activity while you're away. Examples of rental business purposes include:

- Traveling to your rental property to deal with tenants, maintenance, or repairs
- Traveling to building supply stores or other places to obtain materials and supplies for your rental activity
- Traveling to your rental property to show it to prospective tenants
- Learning new skills to help in your rental activity, by attending landlord-related classes, seminars, conventions, or trade shows, and
- Traveling to see people who can help you operate your rental activity, such as attorneys, accountants, or real estate brokers.

On the other hand, rental-related activities don't include:

- Sightseeing
- Recreational activities that you attend by yourself or with family or friends, or
- Attending personal investment seminars or political events.

Use common sense when deciding whether to claim that a trip is for your rental activity. If you're audited, the IRS is likely to question any trip that doesn't have some logical connection to your rental activity.

Caution!

Travel for building improvements isn't deductible. You cannot deduct the cost of traveling away from home if the primary purpose of the trip is to improve your rental property. The cost of travel for improvements must be added to the cost of the improvement and recovered by taking depreciation over many years. In contrast, travel costs for repairs are currently deductible operating expenses. (See Chapter 1 of course 34303C for a detailed discussion of how to tell the difference between repairs and improvements for tax purposes.)

Travel Must Be Ordinary and Necessary

To be deductible, your travel expenses must be ordinary and necessary. So, the trip and the expenses you incur must be helpful and appropriate for your rental activity, not necessarily indispensable. Traveling to a rental property isn't always ordinary and necessary.

Example

Rayford Strickland owned two parcels of real estate about 500 miles from his tax home in Texas. During a two-year period, he made 80 trips to the property at a claimed cost of $11,000. The properties generated a total of $1,653 in income during this time. The IRS and tax court disallowed Strickland's travel expense deductions. The court found that the 80 trips weren't an ordinary and necessary expense because Strickland was unable to provide any explanation of why it was necessary to make so many trips to the two properties. (*Strickland v. Comm'r.*, 43 T.C. Memo 1061.)

Travel Before You Become a Landlord

You must be involved in an ongoing rental activity to deduct your business trips. Trips you take to investigate acquiring your first rental property aren't currently deductible business travel expenses.

Example

Michelle, a San Francisco resident, has never owned any rental property, but would like to buy some. She has heard that there are good buys in Reno, Nevada, so she takes several trips there to search for income properties. She can't currently deduct her travel expenses because she isn't yet in business.

Travel to View Rental Properties for Sale

You must clear several hurdles to deduct travel expenses you incur while looking at rental properties to purchase. You may not deduct expenses you incur to find new properties to buy if your rental activity is an investment, instead of a business, for tax purposes. Investors may not deduct expenses incurred to find new investments. Most landlords are in business. (*Frank v. Comm'r.*, 20 T.C. 511.) (See Chapter 1 of course 34302C for a detailed discussion of whether a rental activity qualifies as a business or an investment.)

If your rental activity is a business, travel costs to look for properties to purchase fall into two categories:

- Expenses incurred to look at properties you purchase, and
- Expenses incurred to look at properties you don't purchase.

Expenses you incur to look at a property you end up buying must be added to the basis of your property and depreciated over 27.5 years along with the rest of the property. (Rev. Rul. 77-254.) This means it will take a long time to fully deduct your travel expenses for a property you buy.

If you look at rental property on a trip, but don't buy it, your travel expenses can be currently deductible as an operating expense, but only if you are already engaged in a rental business in the geographic area where the property is located. Unfortunately for landlords who like to travel, the IRS and courts have taken a restrictive view of the geographic area in which a small landlord is in business, holding that it extends only to the area where the landlord already owns property.

Example

Patrick O'Donnell, a Chicago resident who owned two apartments in Las Vegas, took a two-day trip to Miami to investigate buying a rental property there. However, he decided not to go through with the deal. Both the IRS and tax court denied him a deduction for his travel expenses. The court found that, even though O'Donnell was in the rental business in Las Vegas, his business didn't extend to Miami. Because he was not in business in Miami, he couldn't deduct as a business operating expense his costs to travel there to look at properties. If he had actually bought a rental property in Miami, his travel expenses to purchase it would still not be currently deductible. Instead, he would have to add the cost to the property's basis and depreciate it over 27.5 years. However, if he had also incurred expenses to look at properties he didn't buy before finding the property he did buy, those expenses could be deducted as business start-up expenses; see Chapter 2 of course 34305C. (*O'Donnell v. Comm'r.,* 62 T.C. 781.)

It's unclear exactly how large an area the IRS and tax court would say a small landlord does business in. For example, would O'Donnell in the above example have been able to deduct the expenses of looking for rental properties in Reno, Nevada, or Los Angeles? No one knows. It is clear, however, that your best case for being able to deduct travel expenses is where you look for property in or near an area where you already own rental real estate. Once you start traveling outside of the area where you already own rental property, you'll have a tougher time claiming the deduction with the IRS, especially if you travel to a vacation destination like Miami or Hawaii.

If you travel outside your area of business to look at new rental properties and decide to take your chances with the IRS and claim the deduction, be sure to properly document your expenses and the time you spend looking for rental properties on your trip. You'll have a problem only if you're audited. But, claiming large travel deductions as a landlord will definitely increase your chance of getting audited.

DEDUCTIBLE TRAVEL EXPENSES

Subject to the limits covered in "How Much You Can Deduct," below, virtually all of your travel expenses are deductible. These costs fall into two broad categories: your transportation expenses and the expenses you incur at your destination.

Transportation expenses are the costs of getting to and from your destination—for example: