



SHORT-TERM RENTAL TAX STRATEGY QUICK WALKTHROUGH

Tired of big tax bills year after year, with deductions that barely move the needle? If you want a legal way to lower what you owe the IRS, this strategy may help.

What Is the STR Tax Strategy?

Short-term rentals (average guest stay of 7 days or less, like Airbnb or Vrbo) can:

- 1) Generate income
- 2) Create tax-deductible expenses
- 3) Accelerate depreciation to cut taxable income



Why Is the STR Strategy Different?

Most rental income is passive, so it cannot offset income like W-2 wages. STRs can be different. When an STR is not a rental activity and you materially participate, its income and losses count as active. Losses can then offset active income, with no **Real Estate Professional Status (REPS)** required.

- ✓ STRs can offset active income
- ✓ REPS not required
- ✓ Powerful for W-2 earners, business owners, and investors

Active vs. Passive Income

- **Active Income:** income you work for (W-2, self-employment)
- **Passive Income:** income earned without day-to-day involvement (limited partnerships, most rentals)

A qualifying STR with material participation is treated as active, giving you more flexibility.

How an STR Qualifies as Active (Non-Passive)

There are two steps, and both are required.

- 👉 **Step 1) The activity is not a "rental activity."** Under IRS § 469, rentals are usually passive. Yours is not a rental activity if:
 - Average customer use is 7 days or less, OR
 - Average customer use is 30 days or less AND you provide significant personal services (such as daily housekeeping, meals, or concierge service). Routine cleaning and basic maintenance do not count.

- 👉 **Step 2) You materially participate.** Step 1 only removes the automatic passive label. You must also materially participate by meeting *one* of the seven tests on page 2.
 - See IRS Publication 925 at <https://www.irs.gov/forms-pubs/about-publication-925>.

💡 Pro Tip: Pair a cost segregation study with bonus depreciation to speed up savings. Plan ahead: depreciation you take now can raise your taxable gain at sale (*depreciation recapture*).

What is Cost Segregation?

A study that breaks a property into components you can depreciate faster than the standard 39-year (*commercial*) or 27.5-year (*residential*) schedules, freeing up substantial deductions for property you have built, bought, or renovated.

What is Bonus Depreciation?

A tax break that lets you deduct the full cost of eligible assets in year one instead of over their useful life. The One Big Beautiful Bill Act restored 100% bonus depreciation for qualifying property placed in service after January 19, 2025, making this strategy stronger than ever.



Material Participation Rules

To treat STR income and losses as non-passive, meet just *one* of these seven tests:

- 1) You participated more than 500 hours during the year.
- 2) Your participation was substantially all the participation in the activity, including non-owners.
- 3) You participated more than 100 hours, and no one else (*including non-owners*) participated more. A tie counts.
- 4) The activity is a significant participation activity (*over 100 hours, not material under another test*), and your significant-participation hours total more than 500 for the year.
- 5) You materially participated for any 5 of the prior 10 tax years.
- 6) The activity is a personal service activity and you materially participated for any 3 prior years. Rarely applies to STRs.
- 7) By all facts and circumstances, you participated on a regular, continuous, and substantial basis (*over 100 hours*).



Pro Tip: Keep detailed, contemporaneous time records. With multiple STRs, you can elect to group them as one activity under Reg. Section 1.469-4 so combined hours count toward a single test. File it with your return, and ask your tax advisor first, since the election is generally binding.

Real-Life Example

Gary puts more than 600 hours a year into his STR.
Activities that helped him meet material participation:

- Advertising and marketing the property
- Responding to inquiries and booking requests
- Communicating with guests before, during, and after stays
- Coordinating cleaning and maintenance
- Restocking supplies, linens, and household items
- Managing repairs and improvements
- Setting pricing and managing the calendar and platforms (*Airbnb, Vrbo*)
- Property-related travel (*not personal commuting*)
- Bookkeeping and paying STR bills

Important: Hours from a property manager or contractors (*such as cleaners*) do not count. Neither do investor-only hours, like reviewing financials in a non-managerial role.



Smart Planning Steps

Maximize the strategy with these steps:

- | | | | | |
|---|--|---|--|---|
| A | B | C | D | E |
| Consult an advisor at Asset Strategy | Run a cost segregation study to accelerate depreciation | Track material participation hours | Plan for depreciation recapture at sale | Confirm in-service dates so deductions start on time |

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If you have any questions on the STR Strategy, schedule a 15-Minute Discovery Call today!

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