Guide · Real estate 10 min read

The Short-Term Rental Loophole: When It Really Offsets W-2 and Practice Income

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Updated October 31, 2026 · Written for physicians, tech employees and other high W-2 or practice earners considering a short-term rental

The short answer

Rental losses are normally passive, so they can't offset wages. A short-term rental is the exception when two things are true: the average guest stay is seven days or less (or 30 days or less with hotel-like services), so it isn't a "rental activity" under the passive loss rules; and you materially participate, most often by spending more than 100 hours on it and more hours than anyone else. Then cost segregation and the 100% bonus depreciation restored for property bought after January 19, 2025 can create a first-year loss that offsets W-2 or practice income, up to the 2026 excess business loss limit of $512,000 for married couples. It's a deferral, it needs real hours and a log to prove them, and it fails more often than the online pitch suggests.

Why rentals usually can't offset your salary

Under section 469, a rental activity is passive no matter how much work you do, unless you qualify as a real estate professional, which a full-time physician or engineer can't. Passive losses only offset passive income; the rest waits until you have passive income or sell the property.

The regulations define what a rental activity is, and they exclude property where the average customer use is seven days or less, or 30 days or less when you provide significant personal services like daily cleaning or meals. A typical Airbnb or VRBO with three- to five-night stays falls outside the definition. It's then treated like any other business: passive unless you materially participate, nonpassive if you do. Real estate professional status isn't needed.

Test 1: the average stay

Average stay is the total days rented divided by the number of separate stays during the year, measured property by property. Owner use days aren't rental days. Stays booked by the month for traveling nurses or corporate guests push the average up quickly.

> Check the average every year. A property that averaged 4 nights last year and takes three 30-night bookings this year can drift over 7 and lose the exception for the whole year.

Test 2: material participation

You (with your spouse's hours counted together) must meet one of seven tests for the year. Three are realistic for a short-term rental:

- 500 hours or more on the activity during the year.
- Your participation is substantially all of everyone's participation, including contractors and cleaners. This is rare unless you self-manage and clean.
- More than 100 hours, and at least as many hours as any other individual. This is the one most owners use, and the one most often failed: a cleaner who spends 4 hours on each of 40 turnovers has 160 hours.

Hours that count: guest communication, pricing and listing management, coordinating and checking cleaning and repairs, restocking, doing maintenance yourself, and setting up the property. Hours that usually don't count: reviewing statements, researching the market, travel time to the property and investor-type activities. Keep the log as you go, with dates, tasks and time. Logs rebuilt at tax time are the most common way these claims fall apart under audit.

A full-service property manager usually makes the 100-hour test impossible, because the manager's hours exceed yours. Self-managing with your own cleaners, or a co-host who handles a narrow set of tasks, is the usual setup.

The depreciation that creates the loss

Short-term rentals are generally depreciated as 39-year nonresidential property. A cost segregation study separates out the parts with 5-, 7- and 15-year lives: furniture, appliances, fixtures, flooring, landscaping and site work. That is often 20% to 35% of the building's cost. The One Big Beautiful Bill Act restored 100% bonus depreciation permanently for property acquired after January 19, 2025, so those short-life parts can be deducted in full in the first year.

Worked example: a married couple with $700,000 of W-2 income buys a $1,000,000 short-term rental in January 2026, with 20% of the price allocated to land. A cost segregation study moves 25% of the $800,000 building to short-life property.

Item	Amount
Building (price less land)	$800,000
Short-life property, deducted with 100% bonus	$200,000
39-year depreciation on the rest, first year	about $14,700
First-year depreciation	about $215,000
Federal tax saved at their brackets	about $73,000

The loss offsets wages only up to the excess business loss limit: $512,000 for married couples and $256,000 for others in 2026. Any excess becomes a net operating loss carried forward. Many states don't follow federal bonus depreciation, so the state saving can be smaller. Financing doesn't reduce the depreciation, so the deduction can be larger than the cash you put in.

Where it fails

Hours. The most common failure: not enough hours, more hours by a cleaner or manager, or no credible log.

Timing. Buying in November leaves weeks to log 100 hours and outwork everyone else. Each year is tested on its own.

Personal use. Using the property yourself for more than 14 days, or more than 10% of the days it's rented if that's greater, limits deductions to rental income, so no loss.

Average stay creep. Longer bookings push the average past 7.

A later year you stop participating. The property goes back to passive, and future losses wait.

What happens when you sell

Depreciation lowers your basis. On a sale, the gain on the cost-segregated short-life property is recaptured as ordinary income, and the depreciation on the building is taxed at up to 25%. The loophole is mainly a deferral: you deduct at today's high rate and pay back later, perhaps at a lower rate, or never if you hold until death and your heirs get a stepped-up basis. A 1031 exchange can also defer the gain. Washington doesn't apply its capital gains tax to real estate, but federal recapture still applies.

Frequently asked questions

Does the short-term rental loophole still work in 2026?

Yes. The rules come from the passive activity regulations, which didn't change, and the One Big Beautiful Bill Act made 100% bonus depreciation permanent for property acquired after January 19, 2025, which makes the first-year loss larger.

Do I need to be a real estate professional to use it?

No. Because a property with an average stay of seven days or less isn't a rental activity, you only need to materially participate in it, most often with more than 100 hours and more hours than anyone else.

Can a doctor use the short-term rental loophole?

Yes, if they or their spouse put in the hours. Physicians can't qualify as real estate professionals while practicing full time, which is why this route is popular with them.

How many hours do I need?

Usually more than 100 hours in the year and more than any other single person, including cleaners and co-hosts, or 500 hours on your own. A contemporaneous log is the evidence.

Is there a cap on how much rental loss can offset my wages?

Yes. The excess business loss limit allows business losses to offset up to $512,000 of other income for married couples and $256,000 for others in 2026. The rest carries forward.

General information based on federal law for tax year 2026, not tax advice for your situation. State rules vary.

Want this applied to your situation? Book a free 30-minute call with Akanchya Acharya, CPA at acharyacpa.com/contact or email akansha@acharyacpa.com.

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