

## NEWS ALERT

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### TAX GROUP



## Short-Term Rentals Can Lead to Unexpected Tax Consequences

By Marc T. Finer | March 9, 2022

The short-term rental market that prospered during the COVID-19 pandemic continues to accelerate with concerns over COVID-19 beginning to ease. While owners of rental properties are generally aware that the income generated by the rental activity may be subject to income tax, these owners may be completely surprised to learn that the rental income may also be subject to self-employment tax when significant tenant amenities are included with the rental.

As a rule, rental income attributable to the lease of real estate is not subject to self-employment tax except in the case of a real estate dealer (i.e., one who holds real estate for sale in the normal course of business). However, when “substantial” services are also rendered to, and primarily for the convenience of the tenant, and the services are other than those customarily rendered in connection with the rental of real estate, the rental payments are included in net earnings from self-employment. This is because the payments are considered work performed for the occupant. By comparison, if the owner provides services that are customarily rendered in connection with a leased property and do not constitute a material portion of the rental payments – such as utilities, trash collection and maintenance of common areas – the services are not considered to be rendered to the tenant and the rental payments are not subject to self-employment tax.

Recently issued IRS guidance should help property-owning taxpayers considering vacation rental platforms like Airbnb and VRBO to better understand the overall tax consequences of renting their properties. In Chief Counsel Advice 202151005, the IRS analyzed two short-term rental arrangements to illustrate when rental income may be subject to self-employment tax based on the level of services included with the rental. In the first arrangement, the taxpayer (who was not a dealer) provided linens, kitchen utensils, daily maid service (including delivery of individual use toiletries and other sundries), access to dedicated Wi-Fi, access to beach and other recreational equipment, and pre-paid vouchers for ride-share services between the rental property and the nearest business district. The IRS concluded that the services went beyond those required to maintain the rental property in a condition for occupancy and were of such a substantial nature that the payment for the services was a material portion of the rent. As a result, the payments were subject to self-employment tax.

In the second arrangement, the taxpayer (who was not a dealer) provided a furnished room and bathroom in a dwelling. The taxpayer cleaned the room and bathroom between each occupant’s stay but did not provide any other services. In addition, the occupants did not have access to the common areas such as the kitchen or laundry room during their stay. The IRS concluded that that taxpayer did not provide substantial services beyond those required to maintain the space in

a condition suitable for occupancy and that the services that were provided (i.e., room and bathroom cleaning) did not constitute a material part of the payments made by the occupants. As a result, the rental income was excluded from self-employment tax.

There is no clear rule as to what services might create a self-employment tax liability. Rather, whether services are considered rendered for the occupant is based on the particular facts and circumstances in each case. If the services are of such a substantial nature that the payment for them constitutes a material part of the payments made by the tenant, the services will transform the rental income into self-employment income. Individuals who are engaged in vacation or short-term rental activities should weigh the increased desirability of their property that results from offering an increased level of services against the likelihood that the payments may be subject to self-employment tax if the additional services are found to be substantial. Owners who want to offer substantial services should consider charging separately for the services or having a third party provide the services. Owners who mistakenly assume that the rental income is only subject to income tax may be surprised when they learn that the payments are subject to self-employment tax as well.

*If you have any questions regarding Chief Counsel Advice 202151005, the overall tax impact of engaging in short-term rental activities and/or any potential tax planning opportunities that are available, please contact Marc T. Finer, Tax Partner, at 860-240-6096 or [mfiner@murthalaw.com](mailto:mfiner@murthalaw.com).*

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