ILLUSTRATIVE DECISION MEMO

Rental Loss Offset Decision

Can rental losses offset W-2 income?

PREPARED FOR	**The Anderson Family**
PREPARED BY	Phaenix Advisory Services
REPORT DATE	August 20, 2026
TAX YEAR REVIEWED	2025

Illustrative sample based on the facts shown in the supplied STR diagnostic example. This is not a conclusion for an actual taxpayer.

EXECUTIVE RECOMMENDATION

Executive Answer

A direct conclusion on whether the identified STR losses can reduce W-2 income.

OVERALL ANSWER	EVIDENCE STATUS	PROPERTIES REVIEWED	FILING POSTURE
Conditional	Limited	3	Do not claim all
One property has a viable path	Current file needs strengthening	Evaluated separately	Portfolio-wide offset is not supported

The answer in one paragraph

Conditional yes for one property - not for the portfolio as a whole

Seabreeze Cottage has a viable federal path because its 5.2-day average customer-use period is within the seven-day exception and the recorded 118 owner hours exceed the 74 hours of the next-highest participant. That could support material participation. The evidence is still rated Limited, so the conclusion should not be filed until the booking calculation and participation records are strengthened. Canyon View Retreat remains a rental activity on the facts reviewed. The Ridge House is unresolved and has insufficient participation evidence.

Current exposure summary

$33,500 Prior-year suspended passive losses identified	**$0 quantified** Current-year loss amount provided for this Decision Memo
1 potential property Seabreeze may produce a current-year nonpassive loss if support is completed	**2 unsupported properties** Canyon and Ridge should not offset wages on the current file

Important: the $33,500 identified in the sample records is a prior-year passive carryforward. A change in current-year classification does not automatically convert that carryforward into a wage-offsetting deduction.

Decision basis

01 Classification
Seabreeze is the only property with a verified short-duration indicator close to a supportable conclusion.

02 Participation
Its 118 owner hours appear to exceed both 100 hours and the 74 hours of the next-highest participant.

03 Loss availability
No current-year loss was provided, and the $33,500 carryforward is not automatically released.

Immediate instruction

Complete the Seabreeze evidence file before the return is finalized. If that work cannot be completed, use the conservative passive treatment rather than reconstructing a conclusion after filing.

FACTS AND ASSUMPTIONS

Client & Portfolio Facts

The conclusion is limited to the property-year facts and records listed below.

FILING STATUS	Married filing jointly	PRIMARY INCOME	W-2 + real estate
TAX YEAR	2025	PROPERTIES REVIEWED	3
REPS POSITION	None identified	STATE REVIEW	Separate computation required
SCOPE	Loss usability against wages	EVIDENCE BASIS	Unaudited client-provided records

Property-year facts reviewed

PROPERTY	AVG. STAY	OWNER HOURS	HIGHEST OTHER	CURRENT TREATMENT	PRIOR SUSPENDED LOSS	KEY FACT
Seabreeze Cottage	5.2 days	118	74	Nonpassive	$18,000	Booking average appears within seven-day exception.
Canyon View Retreat	9.4 days	62	142	Passive	$11,500	No seven-day exception; no significant services shown.
The Ridge House	6.1 days*	36	Not complete	New activity	$4,000	Average is partial-year and participation file is incomplete.

**The Ridge House average is based on partial-year reservation records and is not verified for the full tax year.*

Records reflected in this sample

- 2024 and 2025 returns
- Reservation exports and stay summaries
- Owner time logs and activity descriptions
- Known third-party participation
- Depreciation and suspended-loss schedules

Open facts that can change the answer

- Complete-year booking export for each property
- Source support for owner and spouse hours
- Complete third-party and manager hours
- Personal-use day count for The Ridge House
- Current-year loss by property, basis, and at-risk amount
- Modified AGI for the $25,000 special allowance

Diagnostic observations

Different facts

The three properties do not share one classification; each property-year requires its own customer-use and participation analysis.

Old vs. new losses

The return must distinguish current-year losses from prior passive carryforwards before any wage-offset conclusion is modeled.

Evidence controls timing

The conclusion should be finalized only after the missing booking, hour, personal-use, basis, and at-risk records are accepted as complete.

GOVERNING FRAMEWORK

How a Rental Loss Reaches W-2 Income

The question is answered through a sequence of gates, not by a single STR label.

Four possible routes

01 Seven-day exception
Average customer use is seven days or less. The activity is not treated as a rental activity for section 469; material participation is then tested.

02 Thirty-day service exception
Average customer use is 30 days or less and significant personal services are provided. Material participation is still required.

03 Real estate professional route
A rental real estate activity can be nonpassive federally when the taxpayer qualifies as a real estate professional and materially participates. No REPS position was identified here.

04 $25,000 special allowance
A passive rental real estate loss may offset nonpassive income if active participation and MAGI requirements are met. The benefit generally phases out from $100,000 to $150,000 of MAGI.

The order of analysis

1	2	3	4	5	6
Loss exists	**Basis / at risk**	**Personal use**	**Classification**	**Participation**	**Final limits**
Return and depreciation	Loss must first be allowable	Section 280A may limit loss	Rental or trade/business	Owner involvement test	PAL, EBL, and state rules

What the seven-day exception does - and does not do

It removes the activity from the rental-activity definition for passive-loss purposes. It does not by itself make the loss deductible, prove material participation, release old passive carryforwards, establish basis or at-risk capacity, or resolve personal-use and state-law limits.

Most relevant participation tests for this file

>500 hours	Substantially all	>100 and no one more
Not shown	**Not established**	**Seabreeze only**
No property has more than 500 documented owner hours in the supplied sample.	Third parties performed material services, so the file does not currently show substantially all participation.	118 owner hours versus 74 hours for the highest other participant appears to fit this test, subject to validation.

California note: the federal result should not be copied directly to the state return. California amounts and passive-loss computations must be prepared separately, and California does not conform to the federal real-estate-professional exception described in IRC section 469(c)(7).
Primary authorities: Treas. Reg. 1.469-1T(e)(3); Treas. Reg. 1.469-5T; IRS Publication 925 (2025). Full source list appears on page 9.

PROPERTY-BY-PROPERTY CONCLUSION

Classification & Participation Findings

Each property is tested separately because the customer-use and operating facts differ.

PROPERTY	CLASSIFICATION	PARTICIPATION	EVIDENCE	W-2 OFFSET	CONCLUSION
Seabreeze Cottage	Potential nonrental activity	Test 3 appears met: 118 > 100 hours and > 74 hours	Limited	Potential current-year offset	Conditional - verify the stay calculation and strengthen the time file before filing.
Canyon View Retreat	Rental activity	62 owner hours vs. 142 third-party hours	Insufficient	No on current facts	No seven-day exception; no service exception or REPS route established.
The Ridge House	Unresolved	36 documented hours; third-party record incomplete	Insufficient	No on current file	Short-duration indicator is partial-year and participation is not established.

Why Seabreeze is only conditional

STAY-LENGTH GATE	PARTICIPATION GATE	LOSS GATE
5.2 days	118 vs. 74 hours	Not quantified
The seven-day indicator appears satisfied, but the complete booking export and formula must be retained.	The recorded hours fit the 100-hour / no-one-more test, subject to validating owner activities and all other participants.	The current-year loss, basis, at-risk amount, personal-use limit, and excess-business-loss impact were not provided.

Recommended filing position

Do not apply a portfolio-wide nonpassive label. Treat Canyon View Retreat and The Ridge House as passive on the current record. Complete the Seabreeze evidence package, calculate its current-year loss, and then determine the deductible federal and California amounts after basis, at-risk, personal-use, passive-loss, and excess-business-loss limits.

What could change the conclusion

Could improve the result

- Complete Seabreeze booking export confirms seven days or less
- Validated activity descriptions support the 118 hours
- Complete third-party totals confirm no one participated more

Could weaken the result

- Full-year average exceeds seven days
- Nonqualifying investor or reconstruction hours are removed
- A manager, co-host, cleaner, or spouse has more participation
- Personal-use, basis, or at-risk limits reduce the loss

DOCUMENTATION SUPPORT

Evidence & Decision Support

This page evaluates whether the current file can support the classification and participation conclusions.

OVERALL EVIDENCE	BOOKING RECORDS	TIME RECORDS	TAX RECORDS
Limited Some conclusions are supportable; gaps remain	Limited Complete-year export needed	Limited Descriptions and attribution need work	Supported Returns and carryforwards identified

Evidence by category

CATEGORY	STATUS	CURRENT EVIDENCE AND REQUIRED CORRECTION
Average stay	Limited	Reservation summaries exist. Retain the complete annual export, canceled stays, owner stays, and the total-days / number-of-rentals calculation.
Owner participation	Limited	118 hours are listed for Seabreeze, but descriptions, property attribution, and source links are inconsistent.
Third-party participation	Limited	74 hours are identified as the highest Seabreeze third-party total. Confirm all cleaners, co-hosts, managers, contractors, and spouse activity.
Personal use	Insufficient	The Ridge House day count is not complete. Personal-use limits must be tested before claiming a loss.
Loss amount / basis	Insufficient	No current-year loss, basis schedule, at-risk computation, or debt analysis was provided for this Decision Memo.
Prior suspended losses	Supported	$33,500 was identified across the three properties, subject to reconciliation to Form 8582 and the depreciation schedules.

What counts as proof

IRS guidance permits any reasonable method of proving participation; a contemporaneous daily log is not mandatory. The strongest file still ties each activity and approximate hour to objective records such as calendars, platform messages, invoices, mileage, emails, and vendor communications. An unsupported after-the-fact estimate is materially weaker.

How to read the evidence grades

Supported	Limited	Insufficient
The reviewed records are adequate for the limited conclusion, although the underlying facts were not independently audited.	Some support exists, but gaps, inconsistent descriptions, or incomplete source links materially weaken the conclusion.	The current file does not contain enough credible evidence to support the proposed conclusion or quantify the result.

Why this matters: classification determines whether section 469 treats the activity as rental or trade/business; evidence determines whether the taxpayer can sustain the required participation finding. Both must be supportable for a current-year loss to reach wages.

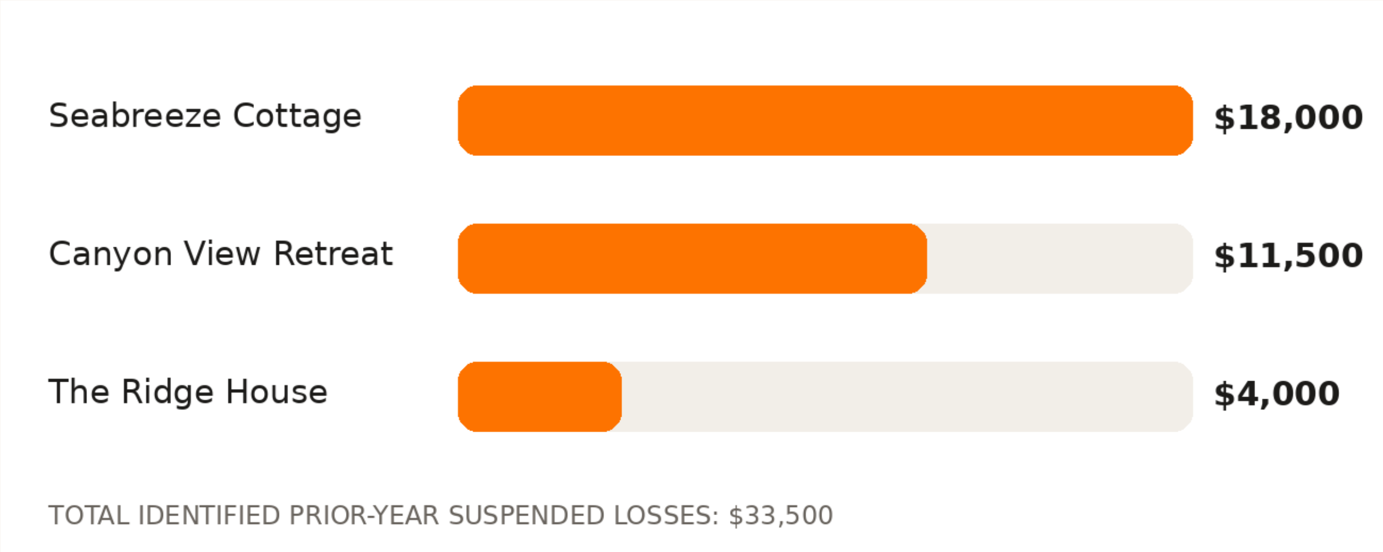
LOSS TREATMENT

Identified Losses & What They Can Offset

Current-year deductions and prior-year passive carryforwards must be separated.

PRIOR SUSPENDED LOSSES	CURRENT-YEAR LOSS	AUTOMATIC RELEASE	POTENTIAL WAGE OFFSET
$33,500	Not provided	No	Seabreeze only
Identified from prior returns	Must be calculated by property	Reclassification alone is insufficient	After evidence and loss limits

Prior-year passive losses identified



Three filing outcomes

OUTCOME	CURRENT-YEAR RESULT	PRIOR CARRYFORWARD	RECOMMENDATION
Claim all losses against W-2	Portfolio-wide nonpassive treatment	Attempt full release	Not supported by the current facts or evidence.
Property-specific treatment	Potential Seabreeze current-year loss only	Carryforward remains governed by former-passive / passive rules	Recommended after evidence is completed and other loss limits are calculated.
Conservative passive treatment	No current wage offset	Losses continue to suspend or offset passive income	Recommended if the Seabreeze file cannot be completed before filing.

A prior passive loss from an activity that becomes nonpassive is generally deductible only up to current-year net income from that former passive activity; the remaining amount continues under the passive-loss rules. A fully taxable disposition can produce a different result and was not analyzed here.

PRIORITY FINDINGS

Action Plan & Filing Route

The work below converts a conditional conclusion into a documented filing decision.

PRIORITY	FINDING	VERIFIED FACT	WHY IT MATTERS	EVIDENCE	OWNER
Immediate	**Complete the Seabreeze stay calculation**	5.2-day average from current summary	The seven-day exception must be established from the complete year.	Limited	Client / Phaenix
Immediate	**Validate participation**	118 owner hours; 74 highest third-party hours	Test 3 depends on both sides of the comparison.	Limited	Client / Phaenix
Immediate	**Separate current and prior losses**	$33,500 is identified as suspended prior-year loss	Carryforwards do not automatically become wage-offsetting losses.	Supported	CPA / Phaenix
Before filing	**Complete personal-use and basis limits**	Ridge personal use and current loss data are incomplete	Other Code limitations can override the section 469 result.	Insufficient	Client / CPA
Before filing	**Compute California result separately**	Federal and California amounts can differ	State depreciation and conformity adjustments may change the allowed loss.	Limited	CPA / Phaenix

Recommended route

Proceed with a property-specific filing decision

Complete the Seabreeze evidence package first. If the full-year stay calculation remains at seven days or less, the 118 hours are supportable, and no other individual exceeds those hours, treat the activity as nonpassive for federal section 469 purposes and calculate only its current-year deductible loss. Keep Canyon passive. Keep Ridge passive unless the missing records produce a different supported result. Do not release the $33,500 prior passive carryforward solely because Seabreeze changes classification.

Records cutoff checklist

01 Booking export All completed and canceled reservations; owner stays; full-year average formula	**02 Owner activity file** Date, property, activity, approximate time, and linked source record	**03 Third-party hours** Managers, cleaners, co-hosts, vendors, and compensated management
04 Loss limitation file Current-year P&L, depreciation, basis, at-risk, debt, and personal-use days	**05 Prior loss reconciliation** Form 8582 carryforwards by activity tied to tax returns	**06 Federal / state model** Allowed federal and California deductions calculated separately

SCOPE AND LIMITATIONS

What This Decision Memo Does - and Does Not Do

A written decision recommendation and a full tax-return computation are different professional tasks.

This Decision Memo answers

"Can the reviewed rental losses offset W-2 income?"

- Activity-classification indicators by property and tax year
- Material-participation evidence and gaps
- Treatment of the identified prior passive carryforwards
- A supportable filing route based on the supplied sample facts
- The records and computations needed before filing

This Decision Memo does not include

Items that require separate records, modeling, or professional scope

- Independent audit or attestation of hours, stays, or source records
- Preparation or amendment of federal or state returns
- A final current-year tax-savings calculation without loss and income data
- A real estate professional qualification study
- Cost segregation, entity design, legal advice, or a disposition analysis

Approved scope limitation

This illustrative Decision Memo is based on unaudited sample facts and the service boundaries described in the Decision Memo client guide. It is not a tax return, legal opinion, audit, attestation, or conclusion for an actual taxpayer. Missing or changed facts can change the result. Phaenix would pause or limit the affected conclusion rather than guess.

Technical authorities used

- Treas. Reg. 1.469-1T(e)(3) - rental-activity definition and the seven-day / 30-day exceptions.
- Treas. Reg. 1.469-5T(a), (b), and (f) - material-participation tests and participation rules.
- IRS Publication 925 (2025) - passive losses, average customer use, the $25,000 allowance, former passive activities, proof of participation, basis / at-risk ordering, and excess business loss coordination.
- California FTB Form 3801 and Form 3885A instructions (2025) - California passive-loss computation and federal / California depreciation and conformity differences.

Next step

Use the findings meeting to confirm the missing evidence, choose the filing route, and assign the final federal and California calculations to the current CPA or to Phaenix under a separate implementation scope.

Decision record

QUESTION ADDRESSED Can the reviewed rental losses offset W-2 income?	**CONCLUSION** Conditional current-year path for Seabreeze only; no portfolio-wide or automatic carryforward release.
EVIDENCE CUTOFF Records shown in the supplied illustrative diagnostic example.	**PREPARED BY** Phaenix Advisory Services - August 20, 2026