



**AMC 2023**

**Session 6**

**Short Term Rentals:  
We All Need a  
Vacation (Home)**

*Leslie B. Elkins, Kramer, Elkins & Watt LLC, Madison  
Jessica M. Kramer, Kramer, Elkins & Watt LLC, Madison  
Stephan H. Mesdjian, Berndt CPA LLC, Madison*

## About the Presenters...

**Leslie Elkins** is an attorney at Kramer, Elkins & Watt, LLC. She practices business, employment and real estate law, acting as a trusted adviser to businesses with needs such as contract drafting and negotiation, business purchases and sales, real estate transactions, lease drafting and negotiation as well as regulation compliance. Leslie assists employers regarding legal issues such as overtime and prevailing wage compliance, drafting employment documents, advising on employee discipline and termination, and administrative representation such as unemployment insurance issues, employee discrimination allegations and department of labor audits.

**Jessica M. Kramer** is the managing partner of Kramer, Elkins & Watt, LLC in Madison. Jessica has been practicing in the Madison area since earning her law degree in 2004 and focuses her practice on commercial real estate with an emphasis on representing landlords, including manufactured home communities, throughout Wisconsin. She provides landlords with comprehensive representation, including drafting customized lease packages, prosecuting evictions, defending administrative actions such as fair housing complaints, and providing day to day advice on tricky tenant issues. Jessica's approach to her practice involves providing the right balance of appropriately aggressive advocacy clients desire and the practical advice they need. Jessica is a trial attorney by training and regularly litigates landlord-tenant matters, employment matters, and business disputes in both trial courts and courts of appeals.

**Stephan Mesdjian**, CPA, EA is a partner at Berndt CPA LLC, specializing in business consulting, tax, and accounting for small businesses with a focus on real estate, professional services, construction, tech, and assisted living facilities. He holds a bachelor's degree in accounting from Edgewood College in Madison, WI. Stephan is also a real estate investor and co-founder of a growing mid-term rental company (Remotely) operating in Madison & Milwaukee. In his free time, he enjoys spending time with his family/friends, traveling, fishing, and soccer.

**Short Term Rentals:**  
**We All Need a Vacation (Home)**

State Bar of Wisconsin Annual Meeting and Conference  
June 16, 2023

**Presenters:**

Attorney Jessica M. Kramer  
Kramer, Elkins & Watt, LLC, Madison

Attorney Leslie B. Elkins  
Kramer, Elkins & Watt, LLC, Madison

Stephan H. Mesdjian, CPA, EA  
Berndt CPA LLC, Madison

**PART ONE: The Legal Stuff (Kramer, Elkins)**

- I. Entity.** Ideally, any short term rental property will be owned by an entity instead of an individual, for purposes of limiting liability exposure.
- a. Options (not exclusive):
    - i. Limited Liability Company (Wis. Stat. Ch. 183)
    - ii. Corporation (Wis. Stat. Ch 180); Consider Statutory Close Corporation (Wis. Stat. § 180.1801 et. seq.)
  - b. Issue: A bank may not want to place the property in the name of a new (or even existing) entity and may require that the person(s) who took out the mortgage keep the property in their name.
  - c. Alternative: Create an entity as a property management company to run the short term rental.

**II. Licensing & Regulation**

- a. Regulation often surrounds:
  - i. Length of rental periods
  - ii. Amount of time over the course of a year the property is rented out
  - iii. Owner-occupancy
- b. State Statutes & Limits on Local Regulation
  - i. A village, city or county may adopt ordinances and a local board of health may adopt regulations regarding the licensees and premises which are stricter than the subchapter. Wis. Stat. § 97.615(2)(g). Many municipalities

enact restrictive regulations, in hopes of encouraging or discouraging short-term rentals, depending on the individual municipality goals.

- ii. “Right to Rent Law”: A municipality may only prohibit rentals fewer than seven days in length. Wis. Stat. § 66.1014(2)(a).
  - 1. Note, this is a change from 2017 in response to municipalities prohibiting rentals of 30 days or fewer, and many municipal ordinances may still reflect the old law. But, any such ordinances inconsistent with the above will not apply and may not be enforced. Wis. Stat. § 66.1014(2)(b).
- iii. A municipality may limit the total number of days in any consecutive 365 day period that the dwelling may be rented to no fewer than 180 days, when the rental periods are more than 6 but fewer than 30 consecutive days. Wis. Stat. § 66.1014(2)(d)(1).
- iv. A person who rents the person's residential dwelling shall notify the clerk of the political subdivision in writing when the first rental within a 365-day period begins. Wis. Stat. § 66.1014(2)(d)(1).
- v. “Short term rental” is defined as a residential dwelling that is offered for rent for a fee and for fewer than 29 consecutive days. Wis. Stat. § 66.0615(1)(dk).
- vi. Pending legislation: 2023 Senate Bill 3. Would prohibit DATCP from regulating swimming pools located at short term rentals; currently such pools qualify as public pools, subject to DATCP regulation.

c. Licensing

- i. Any person who maintains, manages or operates a short-term rental, as defined in Wis. Stat. § 66.0615(1)(dk), for more than 10 nights each year, shall do all of the following:
  - 1. Obtain from the Department of Agriculture, Trade, and Consumer Protection (“DATCP”) a license as a tourist rooming house, as defined in Wis. Stat. 97.01(15k). Wis. Stat. § 66.0615(2)(d)(a).
    - a. [https://datcp.wi.gov/Pages/Programs\\_Services/TouristRoomingHouses.aspx](https://datcp.wi.gov/Pages/Programs_Services/TouristRoomingHouses.aspx)
  - 2. Obtain from a political subdivision a license for conducting such activities, if a political subdivision enacts an ordinance requiring such a person to obtain a license. Wis. Stat. § 66.0615(2)(d)(b).
- ii. No hotel, motel, or tourist rooming house may be opened to the public until the operator of the facility has obtained a license from the department or its agent by submitting an application. ATCP § 72.04(1)(a), Wis. Admin. Code.
  - 1. Licenses are for one year and expire on June 30<sup>th</sup> each year, except that a license initially issued between April 1 and June 30<sup>th</sup> will expire June 30<sup>th</sup> of the next year. ATCP § 72.04(2), Wis. Admin. Code.
- iii. As part of the licensing process, DATCP needs to inspect the property, and may require various aspects of the property be corrected before the license is issued. ATCP § 72.04(5)(c), Wis. Admin. Code.

### III. Municipality Examples

- a. Municipalities typically regulate through zoning ordinances, and sometimes elsewhere in their ordinances; the regulations are sometimes buried deep within a lengthy ordinance relating to a laundry list of uses.
- b. City of Madison
  - i. Must obtain a TRH permit from City of Madison Zoning Administrator and a license from Public Health Madison Dane County. See Licenses and Permits, Supplemental Regulations, Madison General Ordinance Sec. 28.151, *Tourist Rooming House* (a) and (b).
  - ii. TRH must either be: (a) operator's primary residence, or (b) used solely for stays of more than six (6) but fewer than twenty-nine (29) days. See Zoning Ordinance, Sec. 9.29(3)(c)5.
  - iii. "Primary Residence": A dwelling unit that serves as an individual's true, fixed and permanent home for at least 183 days in a calendar year and to which, whenever absent therefrom, that individual intends to return. Additional characteristics of a primary residence include, but are not limited to, where an individual receives mail, claims residence for purposes of voter registration, pays for utilities, and lists as their address on state issued identification cards. An individual can have only one primary residence. Sec. 28.211.
  - iv. For stays of 1 to 6 consecutive days, if the operator does not occupy the residence at the time of rental, TRH may operate no more than thirty (30) days per licensing year. If the operator occupies the residence at the time of rental, there is no limit to the number of days the Tourist Rooming House may operate. Sec. 28.151.
  - v. Quarterly reporting to City Zoning from all TRH operators, to include: name and contact information of the person who made each reservation; dates of stay for all guests during the previous quarter, including whether host was on or off site each night; list of all websites and places TRH has been advertised in the previous quarter.
- c. City of Lake Geneva
  - i. Lake Geneva has mostly enacted the most restrictive allowable laws, within their zoning ordinance.
  - ii. Minimum rental period of seven consecutive days by any one party. Lake Geneva Municipal Code Sec. 98-206(8)(y)(1)(c)(ii).
  - iii. The property owner and designated operators names, addresses and 24-hour phone numbers must be provided to the city of Lake Geneva via the rental application, and the Designated Operator must be available 24/7 during the occupancy time period. Sec. 98-206(8)(y)(1)(c)(vii); (ix).
  - iv. Each property must have a minimum of two off-street parking space, and more depending on number of occupants and guests. Sec. 98-206(8)(y)(1)(d)(ii).
  - v. The City is authorized at all reasonable times upon reasonable notice to the

- owner, with owner's consent or a special inspection warrant under Wis. Stat. § 66.0119, unless an emergency exists where no warrant is required, and as provided in § 66.0199(2) to enter and examine the premises for purposes of ensuring compliance with ordinance. Sec. 98-206(8)(y)(1)(e).
- vi. Violations of the ordinance are subject to separate daily fines, and the annual short-term rental license may be revoked for more than two violations. Sec. 98-206(8)(y)(1)(f).

d. Village of McFarland

- i. Under the "Business" chapter of ordinances
- ii. Short term rental = fewer than 29 consecutive days
- iii. Exclusion for bed and breakfast establishments, as defined in the ordinance
- iv. Requires that every owner of a short term rental appoint a local agent if the owner resides outside a 30-mile radius from the short-term rental or if the owner will be absent (cannot arrive at the TRH within 45 minutes) while the property is being rented. McFarland Municipal Code Sec. 11-352.
  - 1. Subject to Wis. Stats. §§ 111.321, 111.322 and 111.335 (fair employment), agent cannot have been convicted of or have any pending charges for any offense as a felony, misdemeanor, or civil forfeiture involving dishonesty, fraud, deceit, robbery, the use or threatened use of force or violence upon the person of another, or sexual immorality under Wis. Stats. Ch. 944.
- v. Permit only required if renting out TRH more than 10 nights each year; still subject to certain regulations under the ordinance. Sec. 11-353.
- vi. All applications reviewed by committee, then full village board. Sec. 11-356.
- vii. Must submit a "nuisance response plan" with application. Sec. 11-359.

#### IV. Landlord-Tenant Considerations

- a. Questions to ask:
  - i. Could this be a landlord-tenant relationship?
  - ii. Do I want to make sure it is not one?
  - iii. Are there benefits to one over the other? EX: If client wants to avoid licensing and regulation by municipality, rental periods can be minimum 29 days, making them not STR and not subject to such regulation.
- b. Relevant definitions.
  - i. State's definition of STR: fewer than 29 consecutive days.
  - ii. A one-month rental = not STR (unless it's in February of a non-leap year), likely to be subject to landlord-tenant regulations regardless of intention of the parties.
  - iii. "Tenancy" includes a tenancy under a lease, a periodic tenancy, or a tenancy at will. Wis. Stat. § 704.01(4).
  - iv. Not just month-to-month; can be week-to-week or even day-to-day, or any other period for which rent is periodically paid. Wis. Stat. § 704.01(2).

- v. If rent is paid once, or not at regular intervals, there is not a lease for a tenancy (but just a contract for STR), and the stay ends up extending beyond 28 days, you likely have a tenancy-at-will. Wis. Stat. § 704.01(5).
- c. Some annoying requirements would kick in if the relationship is landlord-tenant, that are not likely present with STR, including the requirement to:
    - i. Provide a check in sheet and the notify of needed repairs. Wis. Stat. §§704.07, 704.08.
    - ii. Provide 12 hours' notice before entering premises. ATCP § 134.09(2).
    - iii. Serve a certain notice to terminate the tenancy. Wis. Stat. §§ 704.17, 704.19.
    - iv. Handle a damage deposit as a security deposit, subject to restrictions as to withholding and specific timing for return/accounting. Wis. Stat. § 704.28.
    - v. Use eviction court procedure (likely, a 30-60 day process to remove tenant), even if holdover. Wis. Stat. §§ 704.25, 799.01.
    - vi. Not include certain provisions in the lease for risk of it being void (e.g., fee shifting). Wis. Stat. § 704.44.
  - d. The STR agreement should not only explicitly state that a landlord-tenant relationship is not created, but should state clear limitations on the length of the stay, even with extensions.
  - e. Can a residential tenant rent the place out as a short term rental?
    - i. No prohibition by state law; check ordinances.
    - ii. MGO provides that a renter may operate a TRH if explicitly allowed in the lease. So, even if landlord doesn't care, if the lease doesn't provide it, then the landlord/owner is in violation of the ordinance.
    - iii. Lease can prohibit it, and should be explicit (common lease term prohibiting commercial enterprises is probably not sufficient).

## V. Caselaw

- a. Forshee v. Neuschwander, 2018 WI 62, 381 Wis. 2d 757. Neuschwanders purchased a property on Hayward Lake in Hayward, Wisconsin, Sawyer County and began renting it short-term and long-term. Several neighbors brought action against the Neuschwanders, alleging short-term rentals violated restrictive covenant prohibiting "commercial activity" on the lot.
  - i. The Sawyer County Circuit Court held in favor of the Neighbors and enjoined the Neuschwanders from further short-term rentals, except for the Birkebeiner weekend. The Court of Appeals reversed. The Supreme Court granted the Neighbors' petition for review.
  - ii. The covenant at issue pertains to a 15-lot subdivision and states "there shall be no commercial activity allowed on any of said lots."
  - iii. In reviewing the scope of this covenant, the Supreme Court found that Wisconsin public policy "favors the free and unrestricted use of property," and "restrictions contained in deeds and in zoning ordinances must be

- strictly construed to favor unencumbered and free use of property.” 2018 WI 62 ¶ 16, citing Crowley v. Knapp, 94 Wis. 2d 421, 288 N.W.2d 815 (1980). Accordingly, in order to be enforceable, deed restrictions need to be “expressed in clear, unambiguous, and preemptory terms.” Id.
- iv. The court analyzed how individuals renting the home used the property and found that they use the property in a manner similar to how an owner would – they “buy their own food, cook their own meals, make their own beds and recreate as the house’s location provides, just as a property owner would.” Id. at ¶ 19. It also noted that Louisiana Pacific built the first house in the subdivision and used to provide short stays to clients, vendors politicians and employees. Id. at ¶ 5. The court found that it could not specify the precise activities included in the definition of “commercial activity,” and with the activities of Louisiana Pacific in mind, interpreted the phrase narrowly concluding that short-term rentals are not prohibited. Id. at ¶ 28.
  - v. Note, Justice Abrahamson concurred finding the language unambiguous but that the only activity incurred on the property is not commercial as a factual matter, but residential. Id. at ¶ 43.
- b. Heef Realty and Investments, LLP v. City of Cedarburg Bd. of Appeals, 2015 WI App 23, 361 Wis. 2d 185. Homeowners appealed citations that were issued to them for violating ordinance that allegedly prohibited the from engaging in short-term rentals of their homes in a single-family district. The court of appeals found that the short-term rental was a permitted use in a single-family residential district under zoning code.
- i. The court of appeals reviewed the decision of the Board, not the circuit court. Id. at ¶ 4, citing Murr v. St. Croix Cnty. Bd. of Adjustment, 2011 WI App 29, ¶ 19, 332 Wis. 2d 172.
  - ii. The ordinance at issue listed as permitted uses, “single-family dwellings.” Zoning Code art. C § 13-1-56.
  - iii. In making its decision, this appeals court notes that zoning ordinances “are to be construed in favor of the free use of private property.” Heef Realty at ¶ 7, citing Cohen v. Dane County Bd. of Adjustment, 74 Wis. 2d 87, 91, 246 N.W.2d 112 (1976). Further that “unless the proposed use is unambiguously something other than a single family dwelling under the ... ordinance, the proposed use ... is not prohibited.” Heef Realty at ¶ 7, citing State ex rel. Harding v. Door County Bd. of Adjustment, 125 Wis. 2d 269, 271, 371 N.W.2d 403 (Ct.App.1985).
  - iv. The court found that the language of the ordinance is about the use of the property, not the duration of that use. Heef Realty at ¶ 11. The court of appeals overturned the Board’s decision in interpreting ordinance to preclude short-term rental of a single-family dwelling finding that the ordinance did not clearly and unambiguously prohibit the use. Id. at ¶ 14
- c. Harding v. Door County Board of Adjustment, 125 Wis. 2d 269, 371 N.W.2d 403, (Ct. App. 1985). Door county property owner sought a building permit that would



allow him to build a home for sale to 13 owners who would each have the right to occupy the home for four weeks a year. The circuit court held that the proposed use violated county zoning ordinance that restricted use of property to single family dwelling, and the owner appealed. The court of appeals held that the proposed use fell within the definition of single family dwelling.

- i. The zoning ordinance defines a single family dwelling as a detached building designed for or occupied exclusively by one family, with family defined as “one or more persons related by blood or marriage occupying the premises and living together as a single housekeeping unit.” *Id.* at 271.
- ii. The court cited precedent that it “must strictly construe the ordinance to favor the free use of property.” *Id.*, citing *Crowley v. Knapp*, 94 Wis. 2d 421, 434, 288 N.W.2d 815, 822 (1980). It focused on use and found that “unless the proposed building is unambiguously something other than a single family dwelling under the county ordinance, the proposed use of the building is not prohibited. *Harding* at 271, citing *Cohen v. Dane County Board*, 74 Wis.2d 87, 92, 246 N.W.2d 112, 114 (1976).

## PART TWO: The Tax Stuff (Mesdjian)

### **I. Rental Activities (IRC § 469)**

- a. Income and losses from real estate activities are generally treated as passive income unless engaged in by persons who are in the real estate business.
- b. Passive losses are generally not deductible from other non-passive income (compensation, dividends, interest, etc.)
- c. Exceptions:
  - i. Special rule allows the deduction of up to \$25,000 in losses for MFJ taxpayers who do not have more than \$150,000 in AGI.
  - ii. Real estate professionals

### **II. Dwelling Unit – IRC § 168(e)(2)(A)(ii)(I)**

- a. The term “dwelling unit” includes a house, apartment, condominium, mobile home, boat, or similar property, and all structures or other property appurtenant to such dwelling unit.
- b. Eating, sleeping, bathroom and **not** used as hotel/motel/bed and breakfast. Property is used solely as a hotel, motel, inn, or similar establishment if it is regularly available for occupancy by paying customers and isn’t used by an owner as a home during the year.
  - i. Hotel provides substantial personal services serving transients.
    1. If multiple units in a building and more than half of the units are used on a transient basis then this is not a dwelling but rather a hotel. Subject to 39 year depreciation.

- c. Courts have shown that if there is any personal or other use of the property throughout the year that is not consistent with a hotel, motel, inn, or similar then it is still a dwelling unit.
  - i. Court Cases:
    - 1. Fine, S. Richard v. U.S., (1980, DC IL), Byers Jr., Kenneth, (1984) 82 TC 919, Buchholz, William B., (1983) TC Memo 1983-378, Grigg, Richard A., (1991) TC Memo 1991-392 and Anderson, Charles E., (2006) TC Memo 2006-33

### **III. Personal Residence Rental – IRC § 280A(d)(1) and 280A(g)**

- a. Dwelling unit with personal use that exceeds the greater of 14 days or 10% of the number of rental days rented at fair value and is rented for less than 15 days a year.
- b. No income or expenses reported
- c. Known as the “Augusta rule” or Masters rule”

### **IV. Nonpersonal use rental – IRC § 280A(c)(3)**

- a. If personal use does not exceed the greater of 14 Days or 10% of rental days then considered non-personal use.
- b. Personal use can be
  - i. Home used personally
  - ii. Trades for staying at other homes
  - iii. Donation to charity
  - iv. Rented for less than FMV
  - v. Working on property for more than half the day is not considered personal use, less than half of the day is.
- c. Required to prorate personal/business expenses based on number of days used personally vs total days used.
- d. Personal portion of real estate tax is still deductible on Schedule A but mortgage interest is not.

### **V. Vacation Home – IRC § 280A(d)(1)**

- a. Disallowance of certain expenses in connection with business use of home, rental of vacation homes.
- b. Rented more than 14 days in a year and has personal use that exceed the greater of 14 Days or 10% of rental days.
- c. Direct expenses can be deducted in full
- d. General overhead expenses are deducted based on IRS Method or Bolton Method
  - i. IRS Method – Denominator = Total days used
  - ii. Bolton Method = Total days in year for Tax/Interest
- e. Losses not allowed, they carryforward to offset future vacation home income
- f. Deduct expenses in the following order:
  - i. Proportionate rental share of interest and taxes

- ii. Operating expenses
- iii. Depreciation and casualty Losses
- g. Vacation home carryover losses **may not be** allowed to offset gain on sale (except for depreciation and casualty losses) of vacation home.
  - i. Vacation home rental losses cannot offset other passive income from non-vacation rentals.
  - ii. Income and loss from vacation rental are **not** passive
  - iii. Hours spent on vacation rentals do not count towards real estate professional hours
- h. Personal use interest expense can be deducted on Sch. A if qualified residence interest, subject to the \$750k debt limit.

## **VI. Renting a portion of a dwelling**

- a. Depreciation only allowable on exclusive use portion
- b. Other expenses are allocated between business vs personal use
- c. If exclusive business use allocate expenses any “reasonable way”.
- d. If not exclusive then allocate based on number of days and square footage

## **VII. Short term rentals (Temp. Reg. 1.469-1T(e)(3)(ii)(A))**

- a. <7 days on avg or less than 30 days with substantial services.
- b. To determine if a short-term rental divide the total number of days rented by total rental periods
- c. This test is done annually to determine if a short term rental.
- d. If owner materially participates then the activity is non-passive – losses allowed if not a vacation rental.
  - i. Material Participation Rules:
    - 1. 500 hour rule
    - 2. 100 hour rule and more than anyone else
    - 3. Only participant in activity, etc... 7 tests
- e. Short term rentals are considered a trade or business and not a rental. Whether or not you are a rental for for S469 purposes, this does not define if or if not subject to self-employment tax
- f. Sec. 1402 Self-Employment Tax
  - i. Recent IRS Chief Counsel Advice Memorandum 202151005
  - ii. S1402(A)(1) – no SE tax on rental from living quarters (<7 days is not a rental activity for purposes of S469)
    - 1. Definition of a Rental - rental of living quarters with no significant services provided that are substantial two steps:
      - a. Services to tenant beyond getting the property ready for occupancy?
      - b. Are those services substantial?
        - i. If yes to both, then self-employment tax
        - ii. Revenue Ruling 57-108 - Beach house rental from the 1970’s – offered significant services (Fishing

equip/beach equip/restaurant vouchers/mail  
delivery/etc...)

iii. Hopper tax case is an example of what services you  
can provide that are not substantial – therefore not  
subject to self-employment tax.

g. Substantial services – Determines if subject to self-employment taxes

- i. Not cleaning turnover cleaning, Wi-Fi, cable tv, furnishings
- ii. It can be daily made service, meals, beach deliveries (coolers, chairs,  
beach toys).