

MONEY MYTHS SERIES

Real Estate Professional Status for W-2 Earners: The 750-Hour Myth

The two hour tests for real estate professional status, why W-2 earners usually lose in Tax Court, and California's rule.

By Eric Ridley, attorney, Ridley Law · Updated September 2026 · Read online with live links: ridleylawoffices.com/real-estate-professional-status/

Part of our [money myths series](#), where we check what social media says about money against the statute, the IRS and the courts.

The claim: keep your W-2 job, buy a rental, put in 750 hours, claim real estate professional status, and use the rental's paper losses to wipe out the tax on your salary. **The verdict:** the 750 hours is only half the test. You also have to spend more than half of all your working time in real estate, so someone with a 2,080-hour job needs at least 2,081 real estate hours, about 80 hours of work a week. The Tax Court rejects these claims routinely, and California doesn't recognize the status at all.

750+ hours

Real estate hours required, and only half the test (IRC § 469(c)(7)(B))

2,081

Real estate hours needed by someone with a 2,080-hour job (IRS audit guide)

\$150,000

Income at which the \$25,000 rental loss allowance disappears, unchanged since 1986

\$0

California benefit: the state treats all rentals as passive (R&TC § 17561)

\$512,000

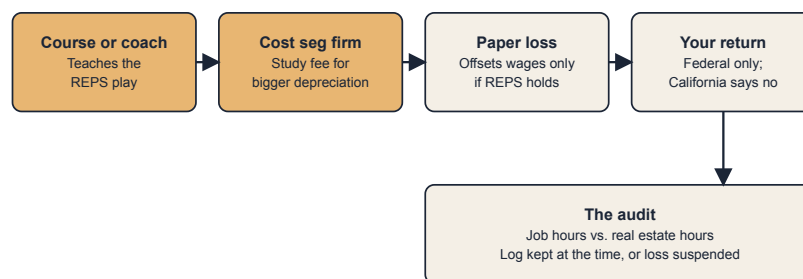
2026 cap on business losses against wages for joint filers (Rev. Proc. 2025-32)

The pitch usually comes with a second purchase. Buy a rental, pay for a cost segregation study to front-load depreciation, and the property throws off a big loss on paper even while it makes money. The 2025 budget law made 100% bonus depreciation permanent for property acquired after January 19, 2025, which makes the paper losses bigger and the pitch louder. The catch is that rental losses are passive by default, and passive losses can't offset wages. Real estate professional status, often shortened to REPS, is the exception people are told to claim.

Who gets paid when you follow this advice

The cost segregation firm, first. One firm's published price list starts its quick study at \$950 and its "Fully Engineered Study" at \$2,320 for residential properties. The IRS's own Cost Segregation Audit Techniques Guide (2025) warns its examiners that "contingency fee arrangements create the incentive to maximize the amount of costs attributed to § 1245 property, usually through 'aggressive' legal interpretations," and tells them to look closely at those studies.

Then the courses, coaching programs and tax-strategy memberships that teach the "REPS plus cost seg" play. We couldn't verify their prices from a reliable source, so we won't print a number. The seller is paid either way. The tax savings only exist if your hours hold up in an audit, and the person who has to prove them is you.



What is real estate professional status?

It's a federal tax status under IRC § 469(c)(7) that lets a taxpayer treat rental losses as non-passive, so they can offset wages and other income, but only if the taxpayer passes two hour tests every year and also materially participates in the rentals.

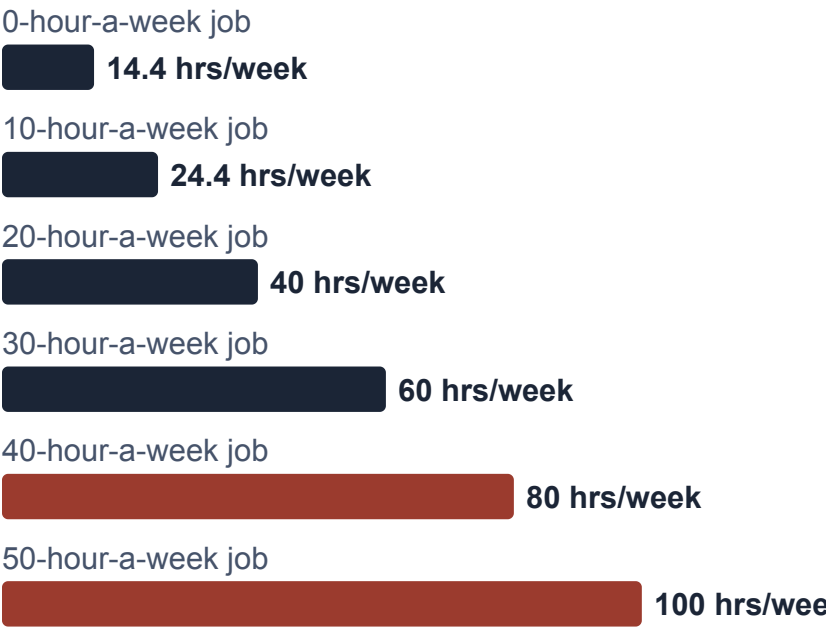
Since 1986, rental activity has been passive by default, and passive losses can only offset passive income. Congress added the real estate professional exception in 1993 for people whose actual work is real estate: developers, builders, brokers, property managers. It was never written for someone with a full-time job elsewhere.

How many hours do you need for real estate professional status?

More than 750 hours a year in real property businesses, and more than half of all the hours you work in any business, according to IRC § 469(c)(7)(B).

The statute requires that "more than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates," and that the taxpayer "performs more than 750 hours of services" in those businesses. Both tests, every year.

The videos quote the second test and skip the first. The IRS's passive activity audit guide spells out the math: "If the taxpayer has a full-time job working 2080 hours a year in a non-real property business, he must work 2081 on his real property businesses." Hours at your W-2 job count on the other side of the scale, and they can't count toward real estate even if your employer is a real estate company, unless you own more than 5% of it.



Computed from IRC § 469(c)(7)(B): more than 750 real estate hours and more than half of all working hours. Assumes 52 working weeks.

Job hours a week	Job hours a year	Real estate hours needed a year	Total hours a week
0	0	751	14.4
10	520	751	24.4
20	1,040	1,041	40
30	1,560	1,561	60
40	2,080	2,081	80
50	2,600	2,601	100

Can my spouse qualify instead?

Yes, if your spouse alone meets both tests; on a joint return, the statute says the requirements are met "if and only if either spouse separately satisfies" them.

A spouse who doesn't have another job, or who works part-time, can qualify by spending more than 750 hours running the rentals. You can't add the two spouses' hours together to reach 750, and IRS Publication 925 says not to count your spouse's services when deciding whether you meet the tests. The IRS audit guide tells examiners to ask pointed questions when a spouse with no other job claims the status, including whether that spouse is "providing full-time care to young children."

What else do you have to prove?

Material participation in the rental itself, usually more than 500 hours on the rentals, which the Ninth Circuit confirmed is a separate requirement for real estate professionals in *Gragg v. United States* (2016).

Qualifying as a real estate professional only removes the automatic "passive" label. You still have to materially participate in the rental activity, and Treasury regulations give the tests: more than 500 hours, or more than 100 hours and at least as much as anyone else. Work "in the individual's capacity as an investor," like reviewing statements, doesn't count. If you own several rentals, you usually need to elect to treat them as one activity, and that election is filed with the original return.

A licensed real estate agent whom the court treated as a real estate professional still lost her rental deductions of \$38,153 because she couldn't show material participation in the rentals themselves. *Gragg* is a Ninth Circuit decision, so it binds federal courts in California.

What happens when W-2 earners claim REPS in Tax Court?

They usually lose, most often because their real estate hours don't exceed their job hours or their logs were built after the fact.

Moss (2010). A full-time nuclear plant technician worked about 1,900 hours a year at his job and claimed 645.5 hours on his rentals, plus time "on call." The court held that on-call time doesn't count, sustained a \$8,070 deficiency and a \$1,614 penalty, and noted he never gave his CPA the hour counts he said he relied on (*Moss v. Commissioner*, 135 T.C. 365).

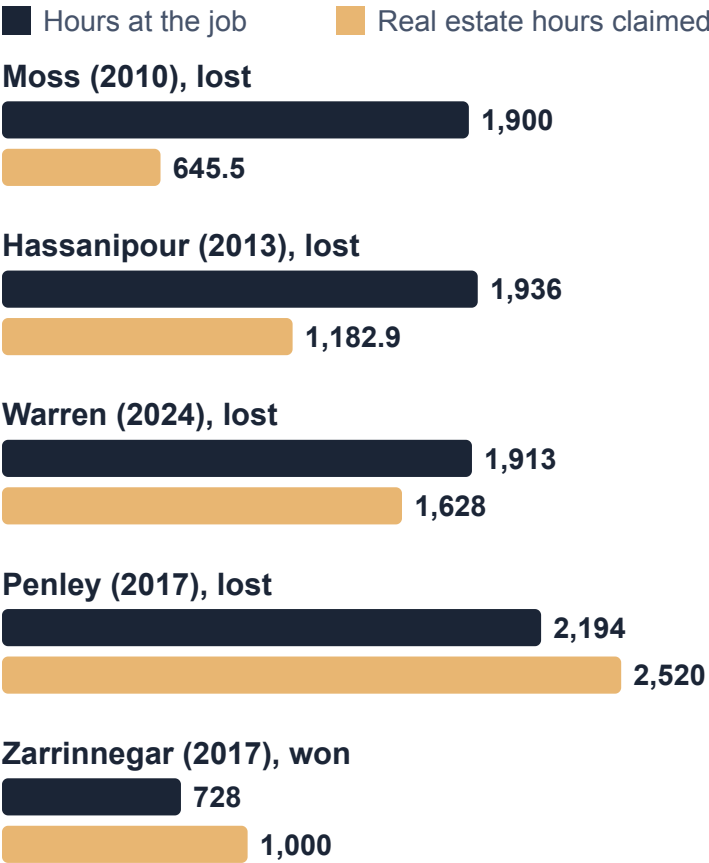
Hassanipour (2013). A California research associate signed employer timesheets showing 1,936 hours of work, then tried to show more time on 28 rental units in Vallejo than at his job. The court found his reconstruction not credible. The couple had reported \$239,037 of wages and \$120,540 of rental losses, and the IRS determined a \$38,067 deficiency and a \$7,613.40 penalty (T.C. Memo. 2013-88).

Penley (2017). A full-time employee who was also a licensed real estate broker logged at least 2,194 hours at his job and claimed 2,520 hours in real estate. The court did the math: he would have needed to average 12.88 hours a day, every day of the year. It found his calendar "greatly exaggerates" his real estate time and held he hadn't shown he was a real estate professional, leaving \$56,863 of loss that the IRS had treated as passive (T.C. Memo. 2017-65).

Warren (2024). A Lockheed Martin engineer worked 1,913 hours at his job and produced a log of 1,628 hours spent on a group home, a log the court noted was "created the night before trial." Even taking the log as true, the hours fell short. His income was over \$150,000, so the \$25,000 allowance didn't help either. The IRS proposed a \$15,392 deficiency and a \$3,078 penalty (T.C. Summ. Op. 2024-20).

Mirch (2025). A California couple, both lawyers, claimed the wife spent 944.5 hours running a short-term rental in Reno. The court found the undated log "was likely created to reach the 750 hours required to qualify as a real estate" professional and found she hadn't shown even 100 hours. The short-term rental fallback failed for the same

reason (T.C. Memo. 2025-128).



Case	Job hours	Real estate hours claimed	Result
Moss v. Commissioner, 135 T.C. 365 (2010)	about 1,900	645.5	Lost
Hassanipour, T.C. Memo. 2013-88	1,936	1,182.9	Lost; reconstruction not credible
Warren, T.C. Summ. Op. 2024-20	1,913	1,628	Lost; log made night before trial
Penley, T.C. Memo. 2017-65	at least 2,194	2,520	Lost; calendar exaggerated
Zarrinnegar, T.C. Memo. 2017-34	about 728	over 1,000	Won; contemporaneous logs

Does California allow real estate professional status?

No: California law says § 469(c)(7) "shall not apply," and the Franchise Tax Board's instructions say that "for California purposes, all rental activities are passive activities" (R&TC § 17561; FTB 3801 instructions, 2025).

A California taxpayer who wins the status federally still gets no state benefit. The rental losses stay suspended on the California return, and California doesn't allow federal bonus depreciation either. For a California household in the 9.3% bracket, that's a large share of the promised savings that was never available.

Worked example: what REPS is worth, and what it costs to lose

The numbers here are hypothetical. A single California filer earns \$200,000 in wages in 2026 and buys a rental that, after a cost segregation study and bonus depreciation, shows a \$40,000 tax loss.

- **Without REPS:** federal tax on \$200,000 of wages, after the \$16,100 standard deduction, is \$36,734. The \$40,000 loss is suspended and carries forward. It isn't lost.
- **With REPS that holds up:** federal tax drops to \$27,134, a \$9,600 saving. California tax doesn't change, because California treats the loss as passive.
- **With REPS that fails an audit:** the \$9,600 comes back, plus a 20% accuracy penalty of \$1,920, plus interest. The \$40,000 loss goes back to being suspended.

A full-time employee in this example would need more than 2,080 documented real estate hours to keep the \$9,600. That's about 40 more hours a week on top of the job, every week, logged as it happens.

Is there a legitimate way to use rental losses?

Yes: a spouse whose main work is real estate can qualify, the \$25,000 allowance helps moderate earners, and suspended losses come back when you sell.

In *Zarrinnegar v. Commissioner*, T.C. Memo. 2017-34, a California dentist who worked about 728 hours a year at his practice and over 1,000 hours on the family's real estate business won, because his logs were credible and kept at the time. Real estate was where he spent most of his working time.

If you actively participate in a rental, IRC § 469(i) lets you deduct up to \$25,000 of losses against other income. That allowance shrinks by 50 cents for every dollar of income over \$100,000 and is gone at \$150,000. Congress set those numbers in 1986 and never indexed them; adjusted for inflation with the Bureau of Labor Statistics' consumer price index, \$150,000 in 1986 dollars would be about \$440,615 in 2025.

And losses you can't use now aren't wasted. They carry forward, and when you sell the whole property in a taxable sale, the suspended losses are released.

What the video says	What the law says
"Just log 750 hours."	750 hours is one test. You also need more than half of all your working hours in real estate.
"Your W-2 job doesn't matter."	Your job hours set the bar. A 2,080-hour job means 2,081 real estate hours.
"Your spouse's hours and yours add up."	One spouse has to meet both tests alone.

What the video says	What the law says
"Cost seg plus REPS wipes out your taxes."	Only federally, only if the hours hold up, and only after material participation in the rentals is also proven.
"Works in every state."	California treats all rentals as passive and doesn't allow bonus depreciation.
"If you don't qualify, the losses are wasted."	They carry forward and are released when you sell.

What should you do instead?

Run the numbers on the rental as an investment first, then treat any tax benefit as a bonus you have to earn with records.

1 Count your job hours honestly

If your W-2 hours are over about 1,000 a year, REPS probably isn't realistic for you. Look at whether a spouse could qualify.

2 Keep a log from day one

Date, task, property and time, recorded as you go. Courts consistently reject logs built months later or the night before trial.

3 Make the aggregation election on time

If you have more than one rental and plan to claim the status, the election to treat them as one activity goes with the original return.

4 Price the cost segregation study against the federal benefit only

California won't give you bonus depreciation or REPS. Ask whether the study fee is fixed or a percentage of the deductions.

5 Plan the exit

Suspended losses come back on a sale. How you hold rentals also matters for your heirs. See [estate planning for real estate investors](#) and [whether your rental belongs in an LLC](#).

Rental-property tax pitches travel in packs. See also [the "1031 forever" DST pitch](#), [the G-Wagon deduction](#) and [asset protection for landlords](#).

Frequently asked questions

Can a full-time W-2 employee qualify as a real estate professional?

Rarely. The real estate hours have to exceed all other working hours, so a full-time employee needs more than 2,080 real estate hours a year on top of the job. Courts have rejected most of these claims.

Does my W-2 job count if I work for a real estate company?

Not unless you own more than 5% of the employer. Services performed as an employee don't count as real property services otherwise.

Do I need a contemporaneous log?

The regulations allow "any reasonable means" of proving hours, but in practice the Tax Court has repeatedly rejected reconstructed calendars and logs prepared for an audit or trial. A log kept as you go is the evidence that wins.

What is the short-term rental loophole?

If guests stay an average of seven days or less, the property isn't treated as a "rental activity" under the passive loss regulations. You still have to materially participate, usually more than 100 hours and more than anyone else, and the Tax Court rejected that fallback in *Mirch* (2025) for lack of proven hours.

Does California recognize real estate professional status?

No. R&TC § 17561 says § 469(c)(7) doesn't apply, and the FTB treats all rental activities as passive for California purposes.

What happens to rental losses I can't deduct?

They carry forward to future years and are released when you sell your entire interest in the activity in a fully taxable sale.

Is there a limit on losses even if I qualify?

Yes. For 2026, the excess business loss rule caps net business losses against non-business income like wages at \$256,000 (\$512,000 joint). The 2025 budget law made that limit permanent.

This page is general information, not legal, tax or investment advice for your situation. Hour tests are fact-heavy and audited closely, so have your own tax preparer review your records before you claim the status.

More in the [money myths series](#).

SOURCES

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- Cost segregation firm price list, [recostseg.com/services](#), accessed October 7, 2026 (marketing).

Questions about your own plan?

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