



IRS Finalizes 199A Safe Harbor for Rental Property

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Foster Swift Business & Tax Law News

November 6, 2019

The IRS recently issued Revenue Procedure 2019-38, which finalizes the safe harbor for rental property under Code Section 199A that was originally provided in IRS Notice 2019-07. The safe harbor treats a rental real estate enterprise as being eligible for the qualified business income deduction under Section 199A, even if it does not meet the definition of a “trade or business” as provided in Treas. Reg. 1.199-1(b)(14).

The safe harbor permits a rental real estate enterprise to be treated as a Section 199A trade or business if sufficient “rental services” were performed for the enterprise. For enterprises in existence for less than four years, 250 hours of rental services are required each year. For enterprises in existence for at least four years, that requirement must only be met for three of the past five years.

The term “rental services” includes: (i) advertising to rent or lease the real estate; (ii) negotiating and executing leases; (iii) verifying information contained in prospective tenant applications; (iv) collection of rent; (v) daily operation, maintenance, and repair of the property; (vi) management of the real estate; (vii) purchase of materials; and (viii) supervision of employees and independent contractors.

Importantly, rental services may be performed by the owner of the enterprise, employees, or independent contractors. One new requirement in the Revenue Procedure is that the taxpayer must maintain time and wage records for any rental services performed by employees or independent contractors. Practically, this requirement should be easy to satisfy since payroll records and invoices would already be issued in the ordinary course.

The safe harbor is not available to: (i) Real estate used by the taxpayer as a residence under section 280A(d); (ii) Real estate rented or leased under a triple net lease; (iii) Real estate rented to a trade or business conducted by a taxpayer or an RPE (relative pass-through entity) which is commonly controlled under Treas. Reg. 1.199A-4(b)(1)(i) (presumably because these entities already qualify for the deduction

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under the common control exception); and (iv) The entire rental real estate interest if any portion of the interest is treated as an SSTB (specified service trade or business) under § 1.199A-5(c)(2).

One of the biggest changes between Notice 2019-07 and the Revenue Procedure is the process of reporting the safe harbor on the taxpayer's return. The Notice only required a statement claiming compliance with the safe harbor requirements. The Revenue Procedure requires a similar statement, plus: (i) a description (including the address and rental category) of all rental real estate properties that are included in each rental real estate enterprise; and (ii) a description (including the address and rental category) of rental real estate properties acquired and disposed of during the taxable year.

Taxpayers may rely on either the Notice or the Revenue Procedure for the 2018 tax year. Taxpayers must use the Revenue Procedure for the 2019 tax year. In a surprise gift, the record keeping requirement does not begin until the 2020 tax year. However, the IRS also cautioned that taxpayers bear the burden of being able to substantiate any claimed deductions.

The safe harbor and its coordination with the rules and regulations under Section 199A is complex and depends on the facts and circumstances surrounding each business. To learn more about whether this safe harbor is a good fit for your business, contact your Foster Swift tax attorney.