



## **Section 199A rental real estate safe harbor rule: The rules continue to evolve - by Sandy Klein**

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For the purposes of the qualified business income deduction (QBID), the Internal Revenue Code and proposed regulations issued in August did not make clear if rental real estate is a trade or business and, therefore, whether it qualifies for the QBID. The Internal Revenue Service provided some additional guidance by issuing in early 2019 a proposed version of a revenue procedure in Notice 2019-07 that contained a safe harbor for treating a rental real estate enterprise as a trade or business solely for purposes of Section 199A.

In late 2019, after considering the public comments it received, the IRS formalized its earlier guidance (with some modifications) in Rev. Proc. 2019-38.

A rental real estate enterprise is an interest in real property held for the production of rents. The interest can be in multiple properties. Commercial and residential real estate cannot be part of the same enterprise. Therefore, they have to be considered as separate enterprises for this purpose.

The Revenue Procedure provides a “safe harbor,” meaning that if the rental real estate enterprise meets certain “trade or business” criteria, it will be eligible for the 20% QBID under IRC section 199A. It should be noted that even if the rental real estate enterprise does not meet these criteria, it may still be treated as a trade or business if it is done continually, and regularly, and the entity or taxpayer’s primary purpose for engaging in the activity is for income for profit. A sporadic activity, non-profit activity, or an amusement or diversion will not qualify under these rules.

The safe harbor criteria are as follows:

1. For rental real estate enterprises that have been in existence less than four years, 250 or more hours of rental services have to be performed with respect to the rental real estate activity per year. For rental real estate enterprises that have been in existence for at least four years, in any three of the five consecutive taxable years that end with the taxable year, 250 or more hours of rental services have to be performed per year with respect to the rental real estate enterprise;
2. The entity must maintain contemporaneous records like time logs, etc. documenting the hours of all services performed, description services, the dates performed, and the name of the person performing; and
3. Separate books and records have to be maintained to reflect income and expenses for each rental real estate enterprise.

Rental services consist of the following:

1. Advertising to rent or lease.
2. Negotiating and executing leases.
3. Verifying information contained in a prospective tenant applications.
4. Daily operation, repair and maintenance of the property.
5. Management of real estate.
6. Purchases of materials.
7. Supervision of employees and contractors.

These services can be performed by the owner, employee, agent of the owner, or an independent contractor hired by the owner.

Rental services do not include the following:

1. Arranging financing of the property.
2. Financial or investment management.
3. Procuring property.
4. Studying and reviewing financial statements.
5. Planning, managing or constructing long-term capital improvements.
6. Travel time to and from the property.

The taxpayer or relevant passthrough entity must attach a statement to a timely filed original return (or an amended return for the 2018 taxable year only) for each taxable year in which the taxpayer or the relevant passthrough entity relies on the safe harbor. An individual or relevant passthrough entity with more than one rental real estate enterprise relying on the safe harbor may submit a single statement but the statement must list the required information separately for each rental real estate enterprise.

The rules surrounding the Section 199A QBID continue to evolve. We encourage you to speak with your tax advisor.

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