

PUBLICATION

Rental Real Estate Enterprises – Section 199A Safe Harbor for Treatment as Trade or Business

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The IRS recently (September 2019) published Rev. Proc. 2019-38, finalizing the proposed safe harbor requirements under which a rental real estate enterprise (RREE) will qualify as a trade or business for purposes of Internal Revenue Code Section 199A. The IRS acknowledged that the question of whether a RREE qualified as a trade or business for purposes of Section 199A has been the subject of much uncertainty. This safe harbor allows taxpayers to know for certain that they are eligible for a qualified business income (QBI) deduction under Section 199A.

A very recent (November 2019) development has occurred which will be of interest to readers of this Alert. The Service has issued Q&As addressing the trade or business aspect of Section 199A as it relates to RREEs. Those Q&As will be addressed in a separate soon-to-be-issued Alert.

Requirements for Safe Harbor

The requirements, largely unchanged from Notice 2019-07 issued in January 2019, are as follows:

Separate books and records must be maintained to reflect income and expenses for each RREE.

For RREEs that have been in existence less than four years, 250 or more hours of rental services must be performed per year with respect to the rental real estate enterprise. For RREEs 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 must be performed per year with respect to the rental real estate enterprise.

Taxpayer must maintain records with respect to (a) hours of all services performed, (b) descriptions of all services performed, (c) dates on which services are performed, and (d) who performed such services.

Taxpayer must attach a statement to a timely filed original return for each taxable year in which the taxpayer relies on the safe harbor. One statement can aggregate all RREEs, but the single statement must separately state the information for each RREE. The statement must include the following information: (1) a description (including the address and rental category) of all rental real estate properties that are included in each RREE; (2) a description of rental real estate properties acquired and disposed of during the taxable year; and (3) a representation that the requirements of this revenue procedure have been satisfied.

If the requirements of the safe harbor are not met, then taxpayers may still qualify outside the safe harbor for a QBI deduction under Section 199A if their RREE otherwise meets the definition of trade or business under the Section 199A regulations.

What are Rental Services?

Rental services for purposes of Rev. Proc. 2019-38 include, but are not limited to: (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, including the purchase of materials and supplies; (vi) management of the real estate; and (vii) supervision of employees and independent contractors. These services may be performed by owners, or by employees, agents, or independent contractors.

The Rev. Proc. 2019-38 specifically excludes from the definition of rental services the following: financial or investment management activities, such as arranging financing, procuring property, studying and reviewing financial statements or reports on operations, property improvements which would be required to be capitalized, or hours spent traveling to and from the real estate.

Excluded Properties

Certain rental real estate arrangements are not eligible for the safe harbor. These properties include:

Real estate used by the taxpayer as a residence under IRC Section 280A(d).

Real estate rented or leased under a triple net lease.

Real estate rented to a trade or business conducted by a taxpayer which is commonly controlled under Treas. Reg. Section 1.199A-4(b)(1)(i).

The entire rental real estate interest if any portion of the interest is treated as a specified service trade or business under Treas. Reg. Section 1.199A-5(c)(2).

These safe harbor requirements are very fact specific. If you have questions regarding these requirements, please contact any member of [Baker Donelson's Tax Group](#).