



Safe Harbor for Rental Real Estate Trade or Business

The 2017 Tax Cuts and Jobs Acts introduced a new deduction of 20% of income from qualifying trade or business under §199A. A qualifying trade or business is not defined in the internal revenue code and therefore, the definition is left to the courts and case law. Whether rental activities rise to the level of trade or business to be eligible for the new 199A deduction is based on facts and circumstances.

Based on courts' decisions, a working definition of a trade or business can be defined as an activity or group of activities conducted on a regular, continuous, and substantial basis to earn a profit. The following factors should be considered when determining if rental real estate meets this definition:

1. Type and number of properties rented,
2. Net lease versus traditional lease, and
3. Most importantly, the day to day involvement of the owner or its agents and the level of services provided.

A safe harbor for a rental activity to qualify as trade or business was finalized in September 2019 under Revenue Procedure 2019-38. Under the safe harbor, a rental real estate enterprise is defined as an interest in real property or multiple properties held for the production of rents either by a pass-through entity or an individual. Taxpayers must either treat each property held for the production of rent as a separate enterprise or treat all similar properties (commercial or residential) as a single enterprise. The real estate enterprise will be treated as a trade or business if the following requirements are met:

1. Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise;
2. At least 250 hours of rental services are performed per year with respect to the rental enterprise, if the enterprise is less than four years old. Otherwise, at least 250 hours of rental services are performed in at least three of the past five years;
3. The taxpayer maintains contemporaneous records including time reports and logs entailing hours of all services performed, descriptions and dates of services, and who performed the services. Note: The contemporaneous records requirement is applicable for 2019 and forward; and
4. The taxpayer must attach a signed statement declaring the safe harbor is being applied to the return, and under penalties of perjury, all of the relevant facts and that such facts are true, correct, and complete.

The rental services required to meet the 250 hours can be performed by owners, employees, agents, and/or independent contractors. The types of services included are:

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

Rental services **do not** include financial or investment management activities, such as the following:

1. Arranging financing,
2. Procuring property,
3. Reviewing financial statements or reports on operations,
4. Improving property, and
5. Traveling to and from the real estate,

Real estate rented or leased under a triple net lease is not eligible for this safe harbor. A triple net lease for this purpose includes a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance and to be responsible for maintenance activities for a property in addition to rent and utilities.

As we head into tax season please consider whether your real estate rental enterprise meets the requirements of the safe harbor detailed above. Also, consider whether all required documentation and records have been maintained throughout the year to substantiate that the requirements of the safe harbor have been met.

If a rental enterprise does not meet the safe harbor requirements, the rental activity could still potentially rise to the level of trade or business eligible for the Qualified Business Income Deduction, if the activity otherwise meets the trade of business definition based on facts and circumstances as referenced earlier.

Contact Us

Please call our office at 843-972-3767 to discuss your potential tax-savings opportunities. We are happy to assist you to ensure that your goals continue to be met.