

**From the desk of
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Internal Revenue Code Section 199A & New Safe- Harbor Rule for Real Estate

The Internal Revenue Service has been extremely slow in providing guidance for the new Internal Revenue Code (IRC) Section 199A under The Tax Cuts and Jobs Act (TCJA) passed late in 2017, especially how the new rules relate to rental real estate.

IRC 199A provides huge benefits to owners of pass-through entities and self-employed individuals with a deduction of up to 20% of the taxpayer's "qualified business income" (QBI), subject to certain limits.

Due to the slow guidance from the IRS there is confusion over the availability of the Section 199A deduction for rental real estate activities.

Recently but well after tax season was over the IRS provided much-needed guidance in Notice 2019-07, and accompanying regulations, featuring a new safe-harbor rule, but unfortunately the Notice was not as definitive as it could have been, and some confusion remains.

The Notice addresses whether a rental real estate activity rises to the level of a trade or business.

The TCJA as written did not establish any real guidance in this area, therefore taxpayers and practitioners were pretty much left in a quandary this past tax season as to how to treat rental real estate in regards to the new law.

Notice 2019-07 now provides some guidance as a safe harbor rule.

A rental activity (including multiple rental activities combined into a single enterprise) is treated as trade or business if the taxpayer spends 250 hours of more on rental services.

To qualify for this 250-hour safe-harbor the taxpayer must also meet the following requirements.

- The taxpayer maintains separate books and records for each rental activity (or the combined enterprise); and
- The taxpayer maintains contemporaneous records, including time reports and similar documents, concerning hours of services performed, a description of all services performed, the dates on which services are performed and the identities of the parties performing the services.

Some of the hours spend on activities relating to a rental estate operation may not count toward the 250-hour threshold.

Notice 2019-17 specifies that rental services do NOT include financial or investment management activities, such as arranging financing; procuring property; studying and reviewing financial statements or reports on operations; planning, managing, or constructing long-term capital improvements; or hours spent traveling to and from the real estate.

Finally, certain rental activities are specifically excluded from the safe harbor rule, such as:

- Real estate you use as a residence for any portion of the year; and
- Any property rented on a triple net lease basis.

The IRS defines a triple net lease as a lease agreement where the tenant or lessee is required to pay taxes, fees and insurance and is responsible for maintenance activities for a property in addition to rent and utilities.

The IRS has announced they will issue additional guidance in this arena in the future.

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