IRS EVICTS SOME LANDLORDS

Not All Rental Real Estate Qualifies for the 199A Pass-Through Deduction

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As we discussed in an **earlier blog**, not every business is classified as a "Qualified Trade or Business" under the TCJA. And as a result not every business will get the 20% deduction. But rental real estate now has its own set of rules in the form of some new Proposed Regulations.

Courts have traditionally held that whether or not rental real estate is an actual business depends on the various facts and circumstances for each situation and how much the owner is physically involved with the rental property.

On the two extremes, in general, if your rental has a "triple net lease" or you use it personally for any part of the year (sorry, no vacation homes), the activity does not rise to the required activity level and you are out of luck. You don't qualify for the deduction. However, if you are considered a "Real Estate Professional" under the rules, you win the 199A lottery and get a deduction, subject to a complex calculation of course.

For those that are in between, things are not quite as certain. Fortunately, the IRS has come up with some additional guidance in the form of what is called a "Safe Harbor", meaning if you meet this minimum requirement , you qualify for the deduction.

On the plus side, similar rental properties can be combined into a single "rental enterprise" to qualify. One caveat though, commercial and residential real estate may not be treated as part of the same rental enterprise. On the negative side, once you decide what rentals to combine, you cannot change the treatment unless you have a significant change in facts and circumstances.

Under the Safe Harbor rules, the owner of the rental activity must do the following:

- Maintain a separate set of books and records, including logs and financial statements, for each rental real estate enterprise (note that's each enterprise, not each building).

- Through December 31, 2022, spend 250 or more hours each year performing rental services for *each* rental enterprise. After that the rules change.

- Maintain contemporaneous (that means done timely, not when the IRS comes calling) records detailing all of the time spent and on what activities, including, at a minimum, the number of hours, description of services performed, date on which the service was performed, and who performed the service. The IRS has a specific list of what activities qualify (think repairs and maintenance) and what doesn't (commuting to and from the property, for example).

- Annually attach a signed statement to the income tax return claiming the safe harbor

This Safe Harbor works for both an individual who puts the rental on page 1 of the Schedule E, or one who holds the property in a relevant pass-through entity (RPE) such as a partnership.

Now, that's not to say that if you don't meet the Safe Harbor, you don't get anything. Like all areas of the tax law, there are quite a few grey areas and exceptions, self-rentals being one of them (hint, hint….they most likely qualify).

And for those who still don't qualify and are unlucky enough to have a rental loss, there is good news and bad news. The good news is the loss will not reduce your other 199A Qualified Business Income and therefore your deduction. The bad news, the other rules like passive activity loss restrictions and rental loss limitations are still around to take a bite out of your loss deduction.

So before you "Move Out and Move On", consult with your tax advisor to see if you can fall under one of the exceptions.

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Victoria has over 25 years of experience in providing tax consulting, compliance and tax audit representation to closely held businesses and the owners of closely held businesses. She delivers a full range of tax services in covering federal and multi-state laws and regulations for partnerships, S and C corporations, and individuals.