



## Final 199A Safe Harbor for Rental Real Estate Changes Little

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On September 24, 2019, IRS issued [Rev. Proc. 2019-38](#), the final safe harbor under which a rental real estate enterprise will be treated as a trade or business for purposes of IRC § 199A. This revenue procedure finalizes rules proposed by the IRS on January 18, 2019, in [Notice 2019-07](#). After reviewing comments on the proposed revenue procedure, the IRS and Treasury made few changes when finalizing the guidance. Below is a summary of the final revenue procedure. Language in the final rule that differs from that in the proposed guidance is in italics.



### Background and Application

The IRS and Treasury created the safe harbor to address concerns that whether an interest in rental real estate rises to the level of a trade or business for purposes of section 199A is the subject of uncertainty for some taxpayers. The safe harbor is designed to “help mitigate this uncertainty.”

The revenue procedure states that the safe harbor is available to taxpayers who seek to claim the section 199A deduction with respect to a “rental real estate enterprise.” If the safe harbor requirements are met, the rental real estate enterprise will be treated as a single trade or business for purposes of the qualified business income deduction, *including for the application of the aggregation rules set forth in Treas. Reg. § 1.199A-4*. Relevant pass through entities (RPEs) may also use the safe harbor.

If an enterprise fails to satisfy the requirements of the safe harbor, the taxpayer *or the IRS* may still establish that an interest in rental real estate is a trade or businesses for purposes of section 199A if it otherwise meets the definition of trade or business in Treas. Reg. § 1.199A-1(b)(14).

### Rental Real Estate Enterprise

A rental real estate enterprise is defined as an interest in real property held for the production of rents and may consist of a single property or interest in multiple properties. The taxpayer or RPE relying on the safe harbor must hold each interest directly or through a disregarded entity.

Taxpayers may either treat each property held for the production of rents as a separate enterprise or treat all similar properties held for the production of rents (unless otherwise ineligible) as a single enterprise. Commercial and residential real estate may not be part of the same enterprise. Once a taxpayer or RPE chooses to treat similar properties as a single rental real estate enterprise, it must continue to do so in future years (*including when it acquires new properties*). A taxpayer or RPE that has chosen to treat its interests as separate

enterprises, however, may choose to treat its interests in similar commercial or similar residential properties as single rental real estate enterprises in a future year.

An interest in mixed-use property may be treated as a single rental real estate enterprise or it may be bifurcated into separate residential and commercial interests. Mixed-use property is defined as a single building that combines residential and commercial units. An interest in mixed-use property, if treated as a single rental real estate enterprise, may not be treated as part of the same enterprise as other residential, commercial, or mixed-use property.

Each rental real estate enterprise that satisfies the requirements of this safe harbor is treated as a separate trade or business for purposes of applying section 199A.

## Safe harbor Factors

The determination to use the safe harbor must be made annually. Solely for purposes of section 199A, a rental real estate enterprise will be treated as a single trade or business if the following requirements are satisfied during the taxable year:

- Maintain separate books and records to reflect income and expenses for each rental real estate enterprise. *If the enterprise contains more than one property, this requirement may be satisfied if income and expense information statements for each property are maintained and then consolidated;*
- For rental real estate enterprises that have been in existence less than four years, perform 250 or more hours of rental services per year with respect to the rental enterprise;
- 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 are performed per year with respect to the rental real estate enterprise;
- The taxpayer maintains contemporaneous records,\* including time reports, logs, or similar documents, regarding the following:
  - hours of all services performed;
  - description of all services performed;
  - dates on which such services were performed; and
  - who performed the services.

\*These records are to be made available for inspection at the request of IRS.

- *The taxpayer or RPE attaches a statement to a timely filed original return (or an amended return for tax year 2018 only) for each taxable year in which they rely on the safe harbor. If the taxpayer or RPE has multiple rental real estate enterprises, they may submit a single statement, but list the information separately for each rental real estate enterprise. The statement must include the following:*
  - *A description (including the address and rental category) of all properties included in the enterprise,*
  - *A description (including the address and rental category) of rental real estate properties acquired or disposed of during the taxable year, and*
  - *A representation that the requirements of the revenue procedure have been satisfied.*

**Note:** The final rule eliminates the “under penalty of perjury” affirmation required by the proposed revenue procedure.

## What rental services qualify?

Rental services, for purposes of the revenue procedure, include, *but are not limited to*, the following:

- Advertising to rent or lease the real estate
- Negotiating and executing leases
- Verifying information contained in the prospective tenant applications
- Collection of rent
- Daily operation, maintenance, and repair of the property, *including the purchase of materials and supplies*
- Management of the real estate
- Supervision of employees and independent contractors

These services may be performed by owners, including owners of an RPE, or employees, agents, or independent contractors of the owners.

## What activities do not count as rental services?

Time devoted to financial or investment management activities, such as the following, will not constitute rental services and cannot be counted toward the 250-hour requirement:

- Arranging financing
- Procuring property
- Studying and reviewing financial statements or reports on operations
- *Improving property under § 1.263(a)-3(d)* (proposed safe harbor said "planning, managing, or constructing long-term capital improvements")
- Hours spent traveling to and from the real estate

## Excluded from the Safe Harbor

The following types of property may not be included in a rental real estate enterprise and are not eligible for the safe harbor:

- Real estate used by the taxpayer (including an owner or beneficiary of an RPE) as a residence under section 280A(d)
- Real estate rented or leased under a triple net lease
  - For purposes of this revenue procedure, a triple net lease includes a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to pay for maintenance activities for a property in addition to rent and utilities. (This language that was in the proposed revenue procedure was stricken from the final rule: "This includes a lease agreement that requires the tenant or lessee to pay a portion of the taxes, fees, and insurance, and to be responsible for maintenance activities allocable to the portion rented by the tenant.")
- *Real estate rented to a trade or business conducted by a taxpayer or an RPE which is commonly controlled under §1.199A-4(b)(1)(i)*
- *The entire real estate interest if any portion of the interest is treated as an SSTB under § 1.199A-5(c)(2) (which provides special rules where property or services are provided to an SSTB).*

## Effective Date

The final safe harbor applies to taxable years ending after December 31, 2017. Alternatively, taxpayers and RPEs may rely on the proposed safe harbor, for the 2018 taxable year. ***The contemporaneous records requirement will not apply to taxable years beginning prior to January 1, 2020.*** But, taxpayers are reminded that they bear the burden of showing the right to any claimed deductions in all taxable years.

## Conclusion

The safe harbor may provide some degree of certainty and assurance for certain taxpayers. It is also helpful that the final rule pushes the contemporaneous records requirement forward to the 2020 tax year, allowing more time for taxpayers to get proper procedures in place. The final revenue procedure, however, retains the same general requirements that limited the proposed rule's effectiveness for resolving uncertainty for many taxpayers who may operate a legitimate rental real estate trade or business. The number of hours (250) is a fairly high requirement for many rental enterprises. Even so, it is a target that can be reached by employing any number of agents to fulfill any number of maintenance tasks. As such, the rule may present a low bar to sophisticated taxpayers who complete low-cost maintenance activities, but perhaps dissuade owners of some legitimate trades or businesses from taking the deduction because the hourly requirement seems out of reach and they want the assurance of a safe harbor.

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