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## **Section 199A rental real estate safe harbor rule: The rules continue to evolve - by Sandy Klein**

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For the purposes of the qualified business income deduction (QBID), the Internal Revenue Code and proposed regulations issued in August did not make clear if rental real estate is a trade or business and, therefore, whether it qualifies for the QBID. Now, the Internal Revenue Service has provided some guidance, by issuing Notice 2019-07. The notice indicates that certain rental real estate enterprises will qualify as a trade or business for the purposes of the QBID.

A rental real estate enterprise is an interest in real property held for the production of rents. The interest can be in multiple properties. Commercial and residential real estate cannot be part of the same enterprise. Therefore, they have to be considered as separate enterprises for this purpose.

The notice provides a “safe harbor,” meaning that if the rental real estate enterprise meets certain “trade or business” criteria, it will be eligible for the 20% QBID under IRC section 199A. It should be noted that even if the rental real estate enterprise does not meet these criteria, it may still be treated as a trade or business if it is done continually, and regularly, and the entity or taxpayer’s primary purpose for engaging in the activity is for income or profit. A sporadic activity, non-profit activity, or an amusement or diversion will not qualify under these rules.

The safe harbor criteria are as follows:

1. At least 250 hours of rental services have to be provided to the activity through 2022 for each year. For 2023 and later, the 250 hour requirement applies in any 3 of the last five years. For example, for calendar year 2023, you meet the safe harbor if you had at least 250 hours of rental services in any 3 years between 2019 and 2023. For activities that are less than five years old, this rule will not apply.
2. The entity must maintain contemporaneous records like time logs, etc. documenting the hours of all services performed, description of services, the dates performed, and the name of the person performing. This requirement is effective as of January 1, 2019.
3. Separate books and records have to be maintained to reflect income and expenses for each rental real estate enterprise.

Rental services consist of the following:

1. Advertising to rent or lease.
2. Negotiating and executing leases.
3. Verifying information contained in prospective tenant applications.
4. Daily operation, repair and maintenance of the property.
5. Management of real estate.

6. Purchases of materials.

7. Supervision of employees and contractors.

These services can be performed by the owner, employee, agent of the owner, or an independent contractor hired by the owner.

Rental services do not include the following:

1. Arranging financing of the property.
2. Financial or investment management.
3. Procuring property.
4. Studying and reviewing financial statements.
5. Planning, managing or constructing long-term capital improvements.
6. Travel time to and from the property.

Real estate used as a personal residence during any part of the year, even if it was converted to a rental, and triple net leases are not eligible for this safe harbor. A triple net lease is a lease agreement that requires the tenant to pay taxes, fees and insurance and is responsible for maintenance activities for the property or for the portion of the property rented by the tenant.

The rules surrounding the Section 199A QBID continue to evolve. We encourage you to speak with your tax advisor.

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