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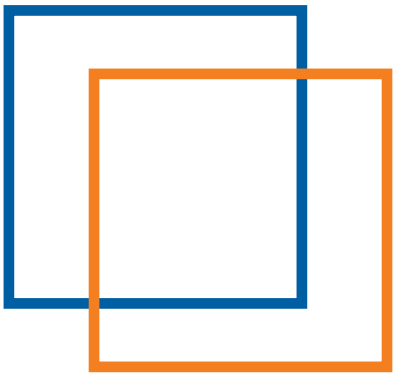
Rental Property & The 199A Deduction

The Rental Property Owner's Guide to the TCJA's Big Tax Deduction



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Good News: Most Rentals Likely Qualify as Section 199A Businesses

The Tax Cuts and Jobs Act (TCJA) tax reform added new tax code Section 199A, which created a 20 percent tax deduction possibility for you if your rental property (a) has profits and (b) can qualify as a trade or business.[1]

As the law now stands, with rentals that achieve trade or business status, you win. Your business-status rental property creates the following five possible tax benefits for you:

1. Your rental property can create a Section 199A tax deduction of up to 20 percent of the rental property's qualified business income (QBI).
2. Your rental property receives tax-favored Section 1231 treatment, which (upon sale) delivers with a tax loss—an ordinary loss (the best kind of loss)—and with a tax-favored capital gain (the best kind of gain).
3. Your rental property can create the home-office deduction if you meet the other home-office requirements of exclusive and regular use.
4. Your rental-business status creates rental property deductions for the cost of your attendance at rental property meetings, seminars, and conventions.
5. Your rental-business status enables Section 179 expensing for certain assets used in the business (special rules apply to the real property).

To obtain the benefits listed above, you must have a rental that qualifies as a trade or business.

New Safe Harbor Is Not the Answer

In Notice 2019-7, the IRS announced its rental property Section 199A tax deduction safe harbor that you can use to qualify your rentals as trades or businesses for purposes of Section 199A regardless of what they really are.[2]

The automatic business treatment in this safe harbor likely does nothing for you. We say this because it's likely that your rental qualifies as a trade or business without considering the safe harbor.

Another problem with the safe harbor is that it does not make your rentals trades or businesses for Section 1231, the home-office deduction, seminars, or the Section 179 deduction. Therefore, if you want to enjoy true business tax benefits from your rentals, you need to know whether they qualify, as a matter of law, as trades or as businesses.

IRS Publication 535

In its draft of IRS Publication 535, the IRS made this statement about Section 199A rental property:

The ownership and rental of real property doesn't, as a matter of law, constitute a trade or business, and the issue is ultimately one of fact in which the scope of your activities in connection with the property must be so extensive as to give rise to the stature of a trade or business.

The "activities . . . must be so extensive" phrase in the above statement is clearly wrong as a matter of law, as you will see below. The IRS admitted that this phrase was an overreach when it removed the phrase from the final IRS Publication 535, which now contains the following:[3]

The ownership and rental of real property may constitute a trade or business.

Big difference!

Four IRS Comments to Consider

In the preamble to the final Section 199A regulations, you find the following four comments:

1. *[S]ection 199A does not require that a taxpayer materially participate in a trade or business to qualify for the Section 199A deduction.*[4]
2. *Providing bright line rules on whether a rental real estate activity is a [S]ection 162 trade or business for purposes of Section 199A is beyond the scope of the final regulations.*[5]
3. *The Treasury Department and the IRS recognize the difficulties taxpayers and practitioners may have in determining whether a taxpayer's rental real estate activity is sufficiently regular, continuous, and considerable* [we deal with this unjustified word below] *for the activity to constitute a [S]ection 162 trade or business. Accordingly, Notice 2019-07, 2019-9 IRB, released concurrently with these final regulations, provides notice of a proposed revenue procedure detailing a proposed safe harbor under which a rental real estate enterprise may be treated as a trade or business solely for purposes of [S]ection 199A.*[6]
4. *A rental real estate enterprise that satisfies the proposed safe harbor may be treated as a trade or business solely for purposes of [S]ection 199A, and such satisfaction does not necessarily determine whether the rental real estate activity is a [S]ection 162 trade or business.*[7]

Harbinger of Where the IRS Is Going

As shown in comment 3 above, the IRS uses the words "sufficiently regular, continuous, and considerable for the activity to constitute a [S]ection 162 trade or business" in justifying its issuance of Notice 2019-7. This is an overreach, as we explain below.

Note how the words above almost mirror the "must be so extensive" comment that the IRS removed from Publication 535.

The Supreme Court in *Groetzinger* stated:[8]

We accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity[,] and that the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify.

In the preamble to its final Section 199A regulations, the IRS adds "considerable" (page 2954) to "regular" and "continuous," with its reference to *Groetzinger*. The word "considerable" does not appear in the *Groetzinger* case.

You can see that the IRS would like the higher standard of "so extensive" or "considerable" to apply to rentals. It does not, as you will see below in the description of *Hazard*, which is the precedent for rental cases other than those in the U.S. Court of Appeals for the Second Circuit.[9]

Hazard Case

Leland Hazard owned residential property in Kansas City, Mo. The property was purchased in 1930 and was occupied by Hazard as his residence from 1930 until July 1939, at which time he moved to Pittsburgh, Pa.

In 1940, Hazard listed the Kansas City property with real estate agents for sale or rent. The property was rented in early 1940 and continued to be rented until it was sold on November 1, 1943.

Hazard recognized a net loss of $6,844.22 ($99,428.42 in today's dollars[10]) from the sale of the property and claimed that the loss was an ordinary loss.

The IRS argued that the loss was a long-term capital loss because the Kansas City property was not used in a trade or business. In other words, the IRS argued that Hazard had held the property simply for investment.

The tax court, relying on *Fackler*, held that the taxpayer recognized an ordinary loss because a single piece of real property that is rented constitutes property used in a trade or business whether or not the taxpayer is engaged in any other trade or business.[11]

The IRS acquiesced in the *Hazard* decision and has consistently followed that decision since 1946.[12]

Second Circuit

The Second Circuit appeals court broke from the trivial rental property activity standard found in *Hazard* when it ruled against Grier, who inherited a single-family home and rented it for 14 years to the same tenant, but could not show regular and continuous management or other activity.[13]

Under the *Golsen* doctrine,[14] the tax court applies the *Grier* ruling to taxpayers who reside in the Second Circuit (Connecticut, New York, or Vermont), and with this residency, you need to show some involvement with your rentals.

Murtaugh Case[15]

In *Murtaugh*, the IRS stressed to the court that this case was appealable to the Second Circuit and that the court must therefore follow the law of the Second Circuit and not *Hazard*.

The IRS and Murtaugh agreed that Murtaugh had a $59,700 loss deduction but disagreed as to its treatment as an ordinary or a capital loss. If Murtaugh could prove that his timeshares were used in a trade or business, he would win an ordinary loss deduction; if not, he had a capital loss.

In making its decision, the court noted that under *Groetzinger*, Murtaugh had to be involved in the timeshares with continuity and regularity; furthermore, his purpose for the timeshares' investment had to be for income or profit.

The court decided for Murtaugh on the basis of his two-day annual visits to the property during the off-season (not a vacation trip) and of the attribution to Murtaugh of the timeshare operators' management activities, which included handling rental contracts, promotional advertising, housekeeping, replenishment of inventory, and guest registration.

Takeaways

If you live outside Connecticut, New York, and Vermont, your precedent for what makes your rental a trade or business is the *Hazard* case. It's hard to think that your rental activities cannot reach the single-family rental property standard set forth in *Hazard*.

And establishing trade or business status under *Hazard* is certainly easier and less complex than establishing rental property business status under the IRS safe harbor laid out in Notice 2019-7.

Even in the Second Circuit, a showing that you are involved in the rental and management of the property should enable you to claim that your rental is a trade or business. Note how Murtaugh won his case based not on his involvement, but on the involvement of the timeshare management company.

All this means that the IRS's "so extensive" and "considerable" guidelines are not on point with what precedent says is a rental property trade or business, so you likely don't have any great reason to subject yourself to the complexities of the safe harbor.

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[1] IRC Section 199A.

[2] IRS Notice 2019-7.

[3] IRS Pub. 535, Business Expenses (2018), dated Jan. 25, 2019, p. 50.

[4] TD 9847, Federal Register, Vol. 84, No. 27, p. 2955.

[5] Ibid.

[6] Ibid.

[7] Ibid.

[8] Commr. v Groetzinger, 480 U.S. 23 (1987).

[9] Hazard v Commr., 7 T.C. 372 (1946), acq. 1946-2 CB.

[10] Per the CPI calculator from the U.S. Bureau of Labor Statistics.

[11] Fackler v. Commr., 45 B.T.A. 708 (1941), aff'd 133 F.2d 509 (6th Cir. 1943).

[12] O.M. 6528, Leland Hazard, A.O.D. (Nov. 26, 1946); See also GCM 38799 for the IRS rejection of a request by the IRS National Audit Office to reverse the acquiescence. Also, see PLR 9426006, where (seven years after Groetzinger) the IRS discusses case law regarding rental property and cites *Hazard* but not *Groetzinger*.

[13] Grier v United States, 46 AFTR 1536 (2nd Cir. 1955).

[14] Golsen v Commr., 54 T.C. 742 (1970).

[15] James B. Murtaugh v Commr., TC Memo 1997-319.

Do Triple-Net Leases Qualify for a 199A Deduction?

Question

I have two rental properties with triple-net leases. They generate taxable income each year. Can I get the 20 percent deduction for them?

Answer

We don't have a clear answer for you, so we are going to go with maybe. As you'll see, we need more information.

Triple-Net Lease Defined

A triple-net lease requires the lessee to pay the landlord rent as well as take care of real estate taxes, building insurance, and property maintenance costs.

Therefore, in a triple-net lease, the lessee bears all the burdens of ownership, and the landlord usually has little to no involvement in the property management.

Section 199A and Rentals

Your rental qualifies for the Section 199A deduction if[1]

1. the rental property qualifies as a trade or business under tax code Section 162, or
2. you rent the property to a commonly controlled trade or business.

Assuming you can't use the commonly controlled route, your rental properties need to rise to the level of a trade or business to get your Section 199A deduction.

To meet that requirement, as we discuss in the above article, you'll generally need to have regular and continuous involvement with your rental activities.

And the proposed regulations require you to look at each rental activity separately when determining whether it is a trade or business—aggregation doesn't help you with this.[2]

Triple-Net Problem

Many triple-net lease rental activities likely fail the regular and continuous activity test and won't qualify for the Section 199A deduction.

For example, in *Neill*, the Board of Tax Appeals (the precursor to the Tax Court) held that a single property leased on a triple-net basis is not a Code Section 162 trade or business.[3]

There's Some Hope

In the preamble to the Code Section 1411 regulations, the IRS gives you other factors to consider when determining whether your rental activity is a trade or business:[4]

- Type of property (commercial vs. residential vs. personal property)
- Number of properties rented
- Day-to-day involvement of the owner or its agent
- Type of lease (net vs. traditional, short-term vs. long-term)

Depending on the particular circumstances of your triple-net lease rental activities, they may rise to the level of a trade or business, even if your involvement with each lease individually is minimal.

Takeaways

Your triple-net lease rental activities face a high hurdle to qualify for the Section 199A deduction. The key reason for a triple-net lease is little to no involvement as a landlord.

You need regular and continuous involvement with your rentals for them to qualify as a business eligible for the Section 199A tax deduction.

But if your triple-net leases have factors in your favor as discussed in the preamble to the code Section 1411 regulations, you may qualify for the Section 199A deduction.

If you really want the Section 199A deduction for your rental activities, you can always modify the lease terms to ensure you have a minimal level of activity, allowing them to rise to the level of a trade or business.

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[1] Prop. Reg. Section 1.199A-1(b)(13).

[2] Ibid.

[3] Neill v. Commr., 46 B.T.A. 197.

[4] T.D. 9644.

IRS Creates a New "Safe Harbor" for Section 199A Rental Properties

Safe harbor! It sounds wonderful.

Obviously, you are going to be comfortable in a safe harbor. And if you said you don't want comfort, you might be thought of as a little loony.

You may sense that we are not jumping with joy about this new safe harbor for Section 199A rental property. It's true; our joy quotient is a little low on this safe harbor because of the work involved.

Our feeling is that you did this work, so your property is a trade or business with no safe harbor needed. Of course, the safe harbor gives you comfort, so we need to examine what's involved.

With the new safe harbor, the IRS thinks it is your new friend when it comes to claiming the Section 199A 20 percent tax deduction on your rental real estate profits.

Your new friend created a fork in the road by giving you an alternative method for finding out whether your rentals qualify for the new 20 percent tax deduction. So now you have a choice between the following two methods:

1. Claim that the rentals are trades or businesses under existing law.
2. Use the new safe-harbor rules.[1]

When you meet the new safe-harbor rules, the IRS deems your rental a trade or business with net rental profits that are qualified business income (QBI) for the Section 199A tax deduction.

But you may not want to use the safe-harbor rules, because they contain some onerous provisions. Also, you may not qualify to use the safe harbor. No problem. You can simply use the second method and win your 199A tax deduction using the existing trade or business tax law rules.

New Tax Term—Rental Real Estate Enterprise

Under the new Section 199A rental real estate safe harbor (and only for this Section 199A safe harbor), each of your rental real estate properties individually or as a group (if you so choose) falls into one of the following categories:[2]

1. Residential real estate enterprise
2. Commercial real estate enterprise
3. Triple net lease real estate

Grouping rule. You (or your pass-through entity) must either[3]

- treat each rental property as a separate enterprise, or
- treat all similar properties as a single enterprise.

Example. Fred has 10 rentals; eight are residential, and two are commercial. None are triple net lease. With grouping, Fred has two enterprises: one residential and one commercial.

With grouping of the residential and no grouping of the commercial, Fred has three enterprises: residential, commercial 1, and commercial 2.

Under this safe harbor, you may not vary your enterprise treatment from year to year unless you have a significant change in circumstances.[4]

(Reminder: You don't have to use the safe-harbor rules for your rental properties. You can use the historical trade or business rules to qualify your rental property for the Section 199A deduction.)

Safe-Harbor Requirements

Solely for Section 199A purposes, the IRS will treat your rental real estate enterprise as a trade or business if you (or your pass-through entity) can satisfy the following requirements:[5]

1. You maintain separate books and records that reflect the income and expenses of each rental real estate enterprise.
2. You perform 250 or more hours of "rental services" during the tax year.[6]
3. You maintain contemporaneous records, including time reports, logs, or similar documents, regarding the following: (i) hours of all services performed, (ii) description of all services performed, (iii) dates on which such services were performed, and (iv) who performed the services. (Note: The contemporaneous records rule does not apply to tax years beginning before January 1, 2019—but don't let this give you false hope; you still need proof.)

Rental Services

Qualifying defined "rental services" can be done by you, your employees, your agents, and/or your independent contractors. Such services include[7]

1. advertising to rent or lease the real estate;
2. negotiating and executing leases;
3. verifying information contained in prospective tenant applications;
4. collecting rent;
5. maintaining, repairing, and daily operation of the property;
6. managing the real estate;
7. purchasing materials; and
8. supervising employees and independent contractors.

Rental services that do not qualify for the safe harbor include[8]

- financial or investment management activities, such as arranging financing, procuring property, or studying and reviewing financial statements or reports on operations;
- planning, managing, or constructing long-term capital improvements; and
- hours spent traveling to and from the real estate.

Reminder. The safe-harbor rules above are solely for Section 199A purposes.

Beware. The passive-activity rules for material participation and status as a real estate professional contain many differences from what you see for the Section 199A tax deduction.

Time log. Your number-one important record for obtaining hassle-free tax deductions on your rental real estate is an accurate and provable time log. If you are using the new Section 199A safe harbor, you now have one additional reason to track time spent.

Nonqualifying Real Estate

Triple net lease property does not qualify for the safe harbor. Remember, the safe harbor is not the only method you can use to qualify your rental real estate for the Section 199A tax deduction.

Also, you may not use the safe harbor on real estate that you use as a residence. If you have a vacation home, Section 280A makes that vacation home either a rental property or a residence.[9]

The Safe Harbor Requires Tax Return Disclosure and a Signed Statement under Penalties of Perjury

You or your pass-through entity must attach a statement to the tax return stating that you are using the safe harbor and you satisfied the requirements set forth in Section 3.03 of Rev. Proc. 2019-XX (the requirements we listed above).[10]

You (or an authorized representative) must have personal knowledge of the facts and circumstances required by the statement above and then assert to the IRS that you have this knowledge with the following declaration:

Under penalties of perjury, I (we) declare that I (we) have examined the statement, and, to the best of my (our) knowledge and belief, the statement contains all the relevant facts relating to the revenue procedure, and such facts are true, correct, and complete.

Trade or Business Route Avoids the Safe Harbor

The preamble to the IRS's new final regulations on Section 199A has this to say about rental real estate:[11]

Providing bright line rules on whether a rental real estate activity is a section 162 trade or business for purposes of section 199A is beyond the scope of these regulations.

This means that if you don't want to use the safe harbor, you need to employ the existing tax law rules on when a rental is a trade or business.

Safe Harbor—No 1099 Issues

If you use the safe harbor, your rental is a business regardless of whether you send 1099s to service providers.

In its preamble to the final Section 199A regulations, the IRS notes that the law requires a trade or business to send 1099s to certain service providers.

Takeaways

You may not find it easy getting to the safe harbor. But remember once you are inside the safe harbor, you have the comfort of knowing that your rental properties are business properties for the possible 20 percent tax deduction under Section 199A.

Now, because of the safe harbor, you have a choice:

- use the safe harbor as described in this article, or
- use the existing tax code trade or business rules to prove that your rental is a trade or business.

And remember, once you are inside the safe harbor, the fact that you did or did not issue 1099s to your service providers is moot for purposes of the Section 199A tax deduction.

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[1] Notice 2019-7.

[2] Ibid.

[3] Ibid.

[4] Ibid.

[5] Ibid.

[6] For taxable years beginning after December 31, 2022, you can meet the 250-hours test in any three of the preceding five years.

[7] Notice 2019-7.

[8] Ibid.

[9] IRC Section 280A.

[10] Notice 2019-7 contains the requirement that will exist in the Rev. Proc. when the IRS issues it. For now, you have Rev. Proc. 2019-XX.

[11] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p. 16.

For 199A Tax Deductions, Must Landlords Give 1099s to Vendors?

The preamble to the Section 199A final regulations contains the following new sentence:

… taxpayers should consider the appropriateness of treating a rental activity as a trade or business for purposes of section 199A where the taxpayer does not comply with the information return filing requirements under section 6041.[1]

Tax code Section 6041 requires a trade or business to issue 1099s to certain vendors.[2]

So, the IRS is saying that you "should consider the appropriateness" of NOT giving 1099s to vendors if you are asserting that your rental property qualifies as a trade or business for the Section 199A tax deduction.

Before you make such a decision, consider first the new IRS safe harbor on 199A rentals and then some rental property history with 1099s.

Safe Harbor

You have two ways to prove that your rental property or activity is a trade or a business:

1. The tax law without considering any Section 199A rules
2. The IRS safe-harbor method

For the Section 199A tax deduction, whether you issue 1099s is irrelevant once you are inside the safe harbor. This doesn't mean that the 1099s are irrelevant for all tax law.

1099 Rental Property History, Part 1

In 2010, the Small Business Jobs Act required all owners of rental properties to issue 1099s to service providers to whom they paid $600 or more.[3] The exact words were contained (but now are repealed, as we explain below) in tax code Section 6041(h), which stated that solely for purposes of 1099 reporting,

a person receiving rental income from real estate shall be considered to be engaged in a trade or business of renting property.

1099 Rental Property History, Part 2

The Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011 repealed the 1099 reporting requirements imposed on rental property

owners by the Small Business Jobs Act.[4] Because of this timely repeal, the application of the more onerous 1099 issuance requirements never took effect.

Here's how lawmakers explained the repeal provision.[5]

Under the provision, recipients of rental income from real estate who are not otherwise considered to be engaged in a trade or business of renting property are not subject to the same information reporting requirements as taxpayers who are considered to be engaged in a trade or business.

As a result, rental income recipients making payments of $600 or more to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income are not required to provide an information return (typically Form 1099-MISC) to the IRS and to the service provider.

What to Do

This is pretty ugly, but you do add credibility to your claim that your rental is a trade or business if you give 1099s to your service providers.

Reminder. If you use the safe harbor for your rental, you don't need the 1099s for the Section 199A deduction.

And the big question is whether your rental property produces taxable income. With no taxable income, the rental is useless for the Section 199A tax deduction because that deduction is limited to business income. (If aggregated, the property might produce an overall Section 199A benefit.)

What to Hope For

When the Small Business Jobs Act required rental property owners to issue 1099s to service providers, it contained exemptions from the 1099 requirements for

- individuals who receive only minimal amounts of rental income, as determined by the secretary in accordance with regulations, and
- individuals for whom the requirements would cause hardship, as determined by the secretary in accordance with regulations.

The 2010 law that required 1099 treatment beginning in 2011 was repealed in 2011, so the law did not take effect. Meanwhile, during that short time, the secretary did not propose any exceptions to the rental property reporting rules, so we have no idea how helpful these might have been.

Raise Hell

If you think that 1099s are necessary to prove that your rental properties are businesses for Section 199A purposes and you believe that treatment is burdensome and unfair, make trouble.

- Call your representatives and senators. Dial 202-224-3121. (Phone calls are harder to ignore than email is.)
- Get your trade association to act on your behalf. (The American Institute of CPAs had a huge hand in undoing the 1099 requirement for rental property owners.)

Takeaways

You likely have not sent 1099s to your rental property service providers and probably don't want to. We understand.

But to lock in your Section 199A deduction on your rentals, the 1099s can help you assert that your rentals rise to the level of a trade or business.

And as you read this, you likely have a problem with the 1099 filing deadlines, some of which were January 31.[6] That's the bad news. The good news is that if you hurry and file now, you can likely avoid any monetary penalties.

Don't forget that you can ignore the 1099 issue for purposes of your Section 199A tax deduction when you use the safe harbor.

And consider this possibility: The new Section 199A tax deduction and the IRS comment on the 1099s in the preamble to the final regulations could easily focus more IRS energy on the previously dormant 1099s that were not being filed by a multitude of rental property owners. This could be an additional reason to start raising hell with your lawmakers so that they will exempt you from the 1099 requirements.

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[1] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p. 21.

[2] IRC Section 6041.

[3] Small Business Jobs Act of 2010, Pub. L. 111-240.

[4] Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, Pub. L. 112-9.

[5] H.Rpt 112-16.

[6] See the 2018 General Instructions for Certain Information Returns, Dated July 20, 2018, p. 26.

How to Handle Multiple Rental Activities and the 199A Deduction

There's a lot of confusion out there around your rental activity and Section 199A. (But certainly less for you as a reader of *Tax Reduction Letter*!)

Your Section 199A considerations multiply when you have multiple rental activities. This can cause true confusion.

We've got you covered when you read this article. You'll get the issues involved, how they affect you, and what you can do.

Big-Picture Issues

If you have multiple rental activities, here's what you need to consider:

- Are your rental activities multiple trades or businesses, or one trade or business?
- Can you aggregate the rentals for Section 199A purposes? Do you want to?
- How does the Section 199A rental safe harbor impact your Section 199A deduction if you use it?
- If you've grouped your rental activities under the tax code Section 469 passive-loss rules, how does that affect your Section 199A choices?

How Many Businesses?

Whether your rental activities are each a trade or business, or they constitute one trade or business, is inherently based on the facts of your particular situation.[1]

The IRS also believes that multiple trades or businesses will generally not exist within an entity unless it can use different methods of accounting for each trade or business under the Section 466 regulations. These regulations explain that you can't consider a trade or business separate and distinct unless you keep a complete and separable set of books and records for that trade or business.[2]

This determination is an important factor for you if any one rental activity (taken individually) doesn't rise to the level of a trade or business, but all the rental activities (viewed collectively) do rise to the level of a trade or business. One of the factors the IRS looks to when determining whether a rental activity is a trade or business is the number of properties rented.[3]

Example. You own one triple-net lease property. A single triple-net lease property likely does not rise to the level of a trade or business.

But what if you own eight triple-net lease properties and manage these activities together? It is likely that the involvement level required for all properties collectively does meet the regular and continuous involvement requirement, and thus that you have one trade or business managing the net lease properties.

Aggregation

The Section 199A regulations allow you to aggregate multiple trades or businesses such that you treat the aggregated group as one trade or business for determining your Section 199A deduction.

This is an important consideration if one or more of your rental businesses has insufficient wages or unadjusted basis in assets (UBIA) to get the maximum Section 199A deduction for that property.

To aggregate, your activities must meet the following five requirements:[4]

1. The same person or group of persons, directly or by attribution, must own 50 percent or more of each trade or business;
2. The ownership above must exist for a majority of the taxable year, including the last day of the taxable year, in which the items attributable to each trade or business are included in income;
3. All the items attributable to each trade or business must be reported on returns with the same taxable year, not taking into account short taxable years;
4. The trades or businesses must not include any out-of-favor specified service trades or businesses; and
5. The trades or businesses must satisfy at least two of the three "facts and circumstances" factors described below.

The three facts and circumstances factors are as follows:[5]

1. The trades or businesses provide products, property, or services that are the same or are customarily offered together.
2. The trades or businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.
3. The trades or businesses are operated in coordination with, or in reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).

Now for the big question: can you aggregate your multiple rental businesses?

The final regulations tell us you can, in most circumstances, provided that the rental activities share centralized administrative functions, such as accounting, legal, and human resources functions.[6]

The big wrinkle is the type of rental business: you generally can't aggregate residential rental businesses and commercial rental businesses with each other because they aren't the same type of property.[7]

Warning. If your rental business qualifies for the Section 199A tax deduction under the commonly controlled rental rule but is an out-of-favor specified service trade or business, you can't aggregate it with your other rentals.[8]

Rental Safe Harbor

Along with the final regulations, the IRS gave you an optional safe harbor to deem your rental activities as qualifying for the Section 199A deduction.

For purposes of the safe harbor only, you arrange your rental activities into rental real estate enterprises (RREEs) to determine whether or not the RREEs meet the 250-hour requirement.

Arranging rental activities in the safe harbor simply determines whether the rental activities qualify for the Section 199A deduction and has no impact on how many rental property trades or businesses you have or on any other Section 199A provision.

Important note. We think that the safe harbor actually has little value, because under existing case law most rental activities qualify as a trade or business anyway.

Section 469 Grouping

You have the option to group activities under tax code Section 469 in order to treat them as one activity under the passive loss rules.[9]

Why would you do this? Because the combined activities are more likely than each one individually to meet the "material participation" standard.

No surprise: the Section 469 grouping applies only to Section 469 rental properties and trades or businesses. The Section 469 grouping has no bearing on Section 199A.

Takeaways

If you own multiple rental properties, you'll likely qualify for the Section 199A deduction.

But you have to consider many things, such as:

- How many trades or businesses do you have?
- Can you aggregate your rentals? Should you?
- Are you going to use the Section 199A rental safe harbor?
- What effect do your existing tax code Section 469 grouping elections have on your Section 199A deduction?

Here are the key things to keep in mind when answering these questions:

- You may have one or more rental activities that individually do not rise to the level of a trade or business but that, when viewed collectively, do rise to the level of a trade or business.
- Aggregation of businesses may give you the best Section 199A deduction. Make sure to calculate the deduction with and without aggregation. You generally can choose to aggregate rentals as long as they are of the same type (e.g., residential with residential but not with commercial). You can have multiple aggregations for multiple types of properties.
- If you choose the Section 199A rental safe harbor, make sure to know the impact on your remaining Section 199A choices.
- Your tax code Section 469 grouping election means nothing to your Section 199A deduction or options.

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[1] TD 9847, Federal Register, Vol. 84, No. 27, p. 2956; Reg. Section 1.183-1(d)(1).

[2] Section 1.446-1(d); TD 9847, Federal Register, Vol. 84, No. 27, p. 2956.

[3] TD 9847, Federal Register, Vol. 84, No. 27, p. 2955.

[4] Reg. Section 1.199A-4(b)(1).

[5] Reg. Section 1.199A-4(b)(1)(v).

[6] Reg. Sections 1.199A-4(d)(16); 1.199A-4(d)(17); 1.199A-4(d)(18).

[7] Reg. Section 1.199A-4(d)(17).

[8] Reg. Section 1.199A-4(b)(1)(iv).

[9] Reg. Section 1.469-4.

Five Popular Tax Reform Articles

IRS FAQs on Section 199A: Nasty? Helpful? Wrong?

On April 11, likely after you filed your tax return, the IRS updated its Section 199A frequently asked questions (FAQs) by increasing the number of questions and answers from 12 to 33. We noted three of the FAQs that will cause problems for many taxpayers. In fact, there will be taxpayers who will need to file amended tax returns because of the FAQs.

Q&A: Simple Recap of TCJA Articles

In this article, you see three easy ways to find the Tax Cuts and Jobs Act (TCJA) articles that we have written: (1) use the resource guide to find the articles by topic with short summaries of the prior and new laws; (2) use the Browse by Topic function; or (3) use the search engine.

Employee Recreation and Parties Survive TCJA Tax Reform

When you know the rules, you can party with your employees and deduct 100 percent of the cost. Interestingly, if you feed your employees during a training program, your deduction is only 50 percent. Make sure you know the rules that give you the 100 percent deduction for employee entertainment.

IRS Issues Final Section 199A Regulations and Defines QBI

Your ownership of a pass-through trade or business can generate a tax deduction of up to 20 percent of your qualified business income (QBI). The C corporation does not generate this deduction, but the proprietorship, partnership, S corporation, and certain trusts, estates, and rental properties do. In this article, you learn how to find your QBI.

Seven Answers to Your Section 199A Questions

The Tax Cuts and Jobs Act tax reform added new tax code Section 199A that gives owners of pass-through businesses a possible 20 percent tax deduction on business income. Inside the rules for qualification, you find some complications that give rise to many questions. In this article, we answer seven of those questions.

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