



nerenj

New guidance for real estate investors on the 20% deduction in tax code, Section 199A - by Lynne Bagby

March 01, 2019 - Northern New England

Lynne Bagby,
Asset Preservation, Inc.

Many New England real estate investors have been wondering how they can qualify for the Section 199A 20% reduction for their real estate “businesses” as they, along with their CPAs and tax advisors maneuver around the recent changes to the tax code.

The Tax Cuts and Jobs Act of 2017 (TCJA) created a new section of the tax code, Section 199A. Section 199A provides a 20% deduction for owners of certain pass-through entities. The intent of this new 20% deduction is to provide some tax rate relief to pass-through entities since C-Corporations benefitted from the reduction in the corporate tax rate from 35% down to 21%.

On January 18, the Treasury released additional guidance regarding the 20% deduction for qualified business income (QBI) and the 20% deduction provided by Section 199A of the code. The IRS provided a proposed revenue procedure and proposed safe harbor describing when a “rental real estate enterprise” will be treated as trade or business for purposes of Section 199A. In Notice 2019-07, the IRS introduced a new tax term, a “rental real estate enterprise” along with conditions that must be met for a rental real estate enterprise to be considered a trade or business and eligible for the Section 199A deduction. For purposes of this safe harbor, a rental real estate enterprise is defined as an interest in real property held for the production of rents and may consist of an interest in multiple properties.

Although most tax advisors will generally recommend that taxpayers try to meet the safe harbor conditions, the Notice provides that the failure of the taxpayer to satisfy the requirements of this safe harbor does not mean a taxpayer cannot substantiate that they have otherwise met the threshold for establishing they have a “rental real estate enterprise” for purposes of Section 199A. The following are the requirements that must be met for the safe harbor:

1. Separate books and records must be maintained for each rental real estate enterprise:
 - A. A real estate enterprise can consist of a single or multiple real estate rentals.

B. Commercial and residential rentals must be in separate enterprises and cannot be combined into the same real estate enterprise.

2. In the tax years 2019-2023, at least 250 hours of rental services must be performed by the taxpayer and workers for the taxpayer for each rental real estate enterprise.

3. The taxpayer must maintain contemporaneous records including time reports, logs, or similar documents, to document the following:

A. Hours of all services performed;

B. Description of services performed;

C. Dates on which such services were performed;

D. Who performed the services.

Rental services that may be counted toward the 250 hour requirement include:

A. Advertising to rent or lease the real estate;

B. Negotiating and executing leases;

C. Verifying information contained in tenant applications;

D. Collection of rent;

E. Daily operation, maintenance, and repair of rental property;

F. Management of the real estate;

G. The purchase of materials for repairs;

H. Supervision of employees and independent contractors.

Rental services for purposes of the rental real estate enterprise safe harbor do not include the following:

A. Financial activities, such as arranging financing;

B. Procuring property;

C. Reviewing financial statements or reports;

D. Planning, managing, or constructing capital improvements;

E. Hours spent traveling to and from rental real estate.

Rental services counted toward the 250 hour requirement may be performed by owners or employees, agents, and/or independent contractors working for the owners. Accordingly, the activities of several individuals may be aggregated for purposes of meeting the 250 hour requirement.

The following types of rental real estate are not eligible for the safe harbor:

A. Real estate owned or managed under a triple net (NNN) lease agreement.

B. Rental property leased under an 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 of the property leased by the tenant.

C. Vacation property used by the taxpayer for any portion of the year.

IRC Section 1031 Exchanges

The Treasury Regulations also provided clarification regarding the calculation of the unadjusted basis immediately after acquisition (UBIA) of replacement property acquired by the taxpayer in a Section 1031 exchange.

Inclusive of the favorable guidance on qualifying for the 20% deduction and the positive outcome on calculating the replacement property basis, New England investors have received more benefits to owning investment property which will ultimately serve to increase ROI. Participation in 1031 exchanges can provide favorable tax benefits at the time of disposition and now, these new tax rules provide a window of opportunity during the ownership of investment property. Coupled together, real estate investors continue to enjoy significant tax benefits for the ownership of investment properties.

Lynne Bagby, CES is the New England division manager for Asset Preservation, Inc., Boston.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540