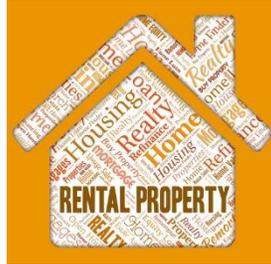


Do Rentals Qualify for the New 20% Business Deduction?



The Treasury Department and the IRS just released some more guidance on the new Section 199A qualified business income (20%) deduction.

A new option was introduced that provides a safe harbor for real estate rentals. There's been a lot of uncertainty and differing views about whether and in what circumstances rental properties will qualify for the deduction, since they're not always viewed as trades or businesses for tax purposes. Having this safe harbor means that if you meet specific criteria and take certain steps, the rental is guaranteed to qualify as a trade or business. A safe harbor merely provides certainty for certain situations. A rental that fails to meet the requirements of the safe harbor might still be properly treated as a trade or business and be eligible for the deduction.

Here are a few highlights of the safe harbor:

- Certain arrangements will not qualify. For example, if the property doubles as your vacation home, the safe harbor doesn't apply. Also, rentals with triple net leases do not qualify for the safe harbor.
- Separate books and records must be maintained for each property. Similar properties (e.g. 4 single-residence homes) can be combined and accounted for together.
- 250 or more hours of "rental services" are required to be provided in conjunction with the rental. Again, similar properties can be combined in order to meet the 250-hour threshold. "Rental services" only includes certain items. For example, efforts to purchase property, secure or update financing or review financial results don't count. But advertising available space, executing leases, collecting rent and repairing the property do count. Starting in 2019, detailed records of the hours must be maintained. Since this safe harbor was just released in 2019, the record-keeping requirement is waived for 2018.

There are a number of additional requirements to securing the safe harbor. Again, while the requirements are quite specific and, in many cases, will not be easily satisfied, your rental(s) may still be eligible for the 20% deduction.

The safe harbor provides us with some insight into the IRS's leanings when considering whether rental activities are trades or businesses qualifying for the deduction. For example:

- It's clear that vacation homes and triple net leases will not be readily viewed as rising to the level of a trade or business.
- Businesses are required to keep detailed books and records, so this also applies to rentals wanting to claim this deduction.
- The provision of services beyond merely making the property available for rent is a key consideration in determining whether a rental activity is a trade or business.

Lastly, businesses are required to issue 1099s for certain of its expenditures. A landlord treating their rental property as a trade or business in order to secure the 20% deduction should do the same.

The provisions of this new deduction are still among the most complex of The Tax Cuts and Jobs Act. Have questions? Contact JPS.

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