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26 CFR 1.199A-1: Trade or Business

(Also: § 199A)

Rev. Proc. 2019-38, Section 3.02

## **SECTION 1. PURPOSE**

This revenue procedure provides a safe harbor under which a rental real estate enterprise will be treated as a trade or business for purposes of section 199A of the Internal Revenue Code (Code) and §§ 1.199A-1 through 1.199A-6 of the Income Tax Regulations (26 CFR Part I). The safe harbor provided by this revenue procedure applies solely for purposes of section 199A. If an enterprise fails to satisfy the requirements of this safe harbor, it may be treated as a trade or business for purposes of section 199A if the enterprise otherwise meets the definition of trade or business in § 1.199A-1(b)(14).

## **SECTION 2. BACKGROUND**

.01 *In general.* Section 199A was enacted on December 22, 2017, as part of the Tax Cut and Jobs Act, Pub. L. 115-97, and was amended on March 23, 2018, retroactively to January 1, 2018, by the Consolidated Appropriations Act, 2018, Pub. L. 115-141. Congress enacted section 199A to provide a deduction to non-corporate taxpayers of up to 20 percent of the taxpayer's qualified business income from each of

the taxpayer's qualified trades or businesses, including those operated through a partnership, S corporation, or sole proprietorship, as well as a deduction of up to 20 percent of aggregate real estate investment trust dividends and qualified publicly traded partnership income.

*.02 Trade or business.* Section 199A(d) defines a qualified trade or business as any trade or business other than a specified service trade or business (SSTB) or a trade or business of performing services as an employee. Section 1.199A-1(b)(14) defines trade or business for purposes of section 199A as a trade or business under section 162 other than the trade or business of performing services as an employee. In addition, § 1.199A-1(b)(14) provides that rental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a section 162 trade or business is nevertheless treated as a trade or business for purposes of section 199A, if the property is rented or licensed to a trade or business conducted by the individual or a relevant passthrough entity (RPE) which is commonly controlled under § 1.199A-4. Sections 1.199A-5(b) and 1.199A-5(d) define an SSTB and the trade or business of performing services as an employee, respectively.

*.03 Notice 2019-07.* The Treasury Department and the IRS are aware 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. To help mitigate this uncertainty, a proposed version of a revenue procedure containing a safe harbor for treating a rental real estate enterprise as a trade or business solely for purposes of section 199A was released for public comment in Notice 2019-07, 2019-09 IRB 740. This revenue procedure is issued following consideration of all public

comments received by the IRS and the Treasury Department and sets forth the safe harbor and the procedural requirements for using it.

### **SECTION 3. RULES OF APPLICATION**

.01 *In general.* This safe harbor is available to taxpayers who seek to claim the deduction under section 199A with respect to a rental real estate enterprise as defined in section 3.02. If the safe harbor requirements are met, the rental real estate enterprise will be treated as a single trade or business as defined in section 199A(d) for purposes of applying the regulations under section 199A, including the application of the aggregation rules in § 1.199A-4. RPEs, as defined in § 1.199A-1(b)(10), may also use this safe harbor. In order to rely upon the safe harbor, taxpayers and RPEs must satisfy all of the requirements of this revenue procedure. Failure to satisfy the requirements of this safe harbor does not preclude a taxpayer or the Service from otherwise establishing that an interest in rental real estate is a trade or business for purposes of section 199A.



.02 *Rental real estate enterprise.* Solely 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 a single property or interests in multiple properties. The taxpayer or RPE relying on this revenue procedure must hold each interest directly or through an entity disregarded as an entity separate from its owner under any provision of the Code.

Except for those property interests described in paragraph .05 of this section, taxpayers and RPEs may either treat each interest in similar property held for the production of rents as a separate rental real estate enterprise or treat interests in all similar properties held for the production of rents as a single rental real estate

enterprise. For purposes of applying this revenue procedure, properties held for the production of rents are similar if they are part of the same rental real estate category. The two types of rental real estate categories for the purpose of combining properties into a single rental real estate enterprise are residential and commercial. Thus, commercial real estate held for the production of rents may only be part of the same enterprise with other commercial real estate, and residential properties may only be part of the same enterprise with other residential properties.

Once a taxpayer or RPE treats interests in similar commercial properties or similar residential properties as a single rental real estate enterprise under the safe harbor, the taxpayer or RPE must continue to treat interests in all similar properties, including newly acquired properties, as a single rental real estate enterprise when the taxpayer or RPE continues to rely on the safe harbor. However, a taxpayer or RPE that chooses to treat its interest in each residential or commercial property as a separate rental real estate enterprise may choose to treat its interests in all similar commercial or all similar residential properties as a single rental real estate enterprise in a future year.

An interest in mixed-use property may be treated as a single rental real estate enterprise or may be bifurcated into separate residential and commercial interests. For purposes of this revenue procedure, 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

and the regulations thereunder.

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

- (A) Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise. If a rental real estate 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;
- (B) For rental real estate enterprises that have been in existence less than four years, 250 or more hours of rental services are performed (as described in this revenue procedure) per year with respect to the rental real estate 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 (as described in this revenue procedure) per year with respect to the rental real estate enterprise; and
- (C) The taxpayer maintains 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. If services with respect to the rental real estate enterprise are performed by

employees or independent contractors, the taxpayer may provide a description of the rental services performed by such employee or independent contractor, the amount of time such employee or independent contractor generally spends performing such services for the enterprise, and time, wage, or payment records for such employee or independent contractor. Such records are to be made available for inspection at the request of the IRS.

(D) The taxpayer or RPE attaches a statement to a timely filed original return (or an amended return for the 2018 taxable year only) for each taxable year in which the taxpayer or RPE relies on the safe harbor. An individual or RPE with more than one rental real estate enterprise relying on this safe harbor may submit a single statement but the statement must list the required information separately for each rental real estate enterprise. The statement must include the following information:

(1) A description (including the address and rental category) of all rental real estate properties that are included in each rental real estate enterprise;

(2) A description (including the address and rental category) of rental real estate properties acquired and disposed of during the taxable year; and

(3) A representation that the requirements of this revenue procedure have been satisfied.

.04 *Rental services.* Rental services for purpose of this revenue procedure include, but are not limited to: (i) advertising to rent or lease the real estate; (ii) negotiating and executing leases; (iii) verifying information contained in prospective tenant applications; (iv) collection of rent; (v) daily operation, maintenance, and repair of the property, including the purchase of materials and supplies; (vi) management of the real estate; and (vii) supervision of employees and independent contractors. Rental services may be performed by owners, including owners of an RPE, or by employees, agents, and/or independent contractors of the owners. The term rental services does not include financial or investment management activities, such as arranging financing; procuring property; studying and reviewing financial statements or reports on operations; improving property under § 1.263(a)-3(d); or hours spent traveling to and from the real estate.

.05 *Certain rental real estate arrangements excluded.* The following types of property may not be included in a rental real estate enterprise and are therefore not eligible for the safe harbor:

(A) Real estate used by the taxpayer (including an owner or beneficiary of an RPE) as a residence under section 280A(d).

(B) 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.

(C) 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).

(D) The entire rental 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).

#### **SECTION 4. EFFECTIVE DATE**

This revenue procedure applies to taxable years ending after December 31, 2017. Alternatively, taxpayers and RPEs may rely on the safe harbor set forth in Notice 2019-07, 2019-09 IRB 740, for the 2018 taxable year. The contemporaneous records requirement will not apply to taxable years beginning prior to January 1, 2020.

However, taxpayers are reminded that they bear the burden of showing the right to any claimed deductions in all taxable years. INDOPCO, Inc. v. Comm’r, 503 U.S. 79, 84; 112 S.Ct. 1039, 1043) (1992); Interstate Transit Lines v. Comm’r, 319 U.S. 590, 593, 63 S.Ct. 1279, 1281 (1943). See also I.R.C. § 6001; Treas. Reg. § 1.6001-1(a) and (e).

#### **SECTION 5. PAPERWORK REDUCTION ACT**

*.01 Collections of Information – Forms 1040, 1040-NR, 1040-SR, 1041, 1065, and 1120S.*

The collections of information in this revenue procedure are in sections 3.03(C) and 3.03(D). The information collection requirement pursuant to section 3.03(C) is discussed further below. The IRS intends that the collections of information pursuant to section 3.03(D) will be conducted by way of attachment to the following:

- Form 1040, U.S. Individual Income Tax Return;
- Form 1040-NR, U.S. Nonresident Alien Income Tax Return;
- Form 1040-SR, U.S. Tax Return for Seniors;
- Form 1041, U.S. Income Tax Return for Trusts and Estates;

- Form 1065, U.S. Return of Partnership Income; or
- Form 1120S, U.S. Income Tax Return for an S Corporation

For purposes of the Paperwork Reduction Act, the reporting burden associated with the collections of information with respect to section 3.03(D) will be reflected in the IRS Forms 14029 Paperwork Reduction Act Submission, associated with the Forms 1040 and 1040-NR (OMB control number 1545-0074), Form 1041 (OMB control number 1545-0092), and Forms 1065 and 1120S (OMB control numbers 1545-0123).

*.02 Collection of Information – Section 3.03(C)*

In contrast to the collections of information pursuant to the provisions of section 3.06(B) (as discussed above), the IRS intends that the information collection requirements pursuant to section 3.03(B) will be satisfied by the taxpayer maintaining contemporaneous records that are adequate to verify the number of service hours performed with respect to a rental real estate enterprise, including (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.

The collection of information contained in section 3.03(C) will be submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1994 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by December 16, 2019.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the duties of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (including underlying assumptions and methodology);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchases of services to provide information.

The collection of information in section 3.03(B) is mandatory for respondents that choose to rely on the safe harbor. The likely respondents are individuals, partnerships, S corporations, trusts, and estates that own rental real estate.

The estimated total annual reporting and/or recordkeeping burden is 5.5 million hours.

The estimated annual burden per respondent/recordkeeper varies from 3 to 10 hours, depending on individual circumstances, with an estimated average of 5 hours. The estimated number of respondents and/or recordkeepers is 1.1 million. This estimate is based on an assumption that only a portion of taxpayers and RPEs with interests in rental real estate (based on numbers of Schedule E and Forms 8825 filed)

will choose to rely on the safe harbor.

The estimated annual frequency of responses (used for reporting requirements only) is annual.

Using the IRS's taxpayer compliance cost estimates, individuals filing Form 1040 Schedule E are estimated to have a monetization rate of \$25.63 per hour. Passthrough entities filing Form 8825 are estimated to have a monetization rate of \$40.16 per hour.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## **SECTION 6. DRAFTING INFORMATION**

The principal authors of this revenue procedure are Robert D. Alinsky, Vishal R. Amin, Margaret Burow, and Sonia K. Kothari of the Office of the Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this revenue procedure contact Robert D. Alinsky or Margaret Burow at (202) 317-5279 or Vishal R. Amin or Sonia K. Kothari at (202) 317-6850 (not a toll-free call).