



TaxNewsFlash

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Rev. Proc. 2019-38: Section 199A “safe harbor” for rental real estate

The IRS today released an advance version of Rev. Proc. 2019-38 to provide a “safe harbor” under which a rental real estate enterprise will be treated as a trade or business for purposes of section 199A and Reg. sections 1.199A-1 through 1.199A-6.

The safe harbor provided by Rev. Proc. 2019-38 applies solely for purposes of section 199A. If an enterprise fails to satisfy the requirements of this safe harbor, it nevertheless 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 Reg. section 1.199A-1(b)(14).

Read [Rev. Proc. 2019-38](#) [PDF 107 KB] and a related IRS release, [IR-2019-158](#)

Background

In January 2019, when regulations under section 199A were released, the IRS and Treasury Department were aware that there was uncertainty whether an interest in rental real estate rises to the level of a trade or business for purposes of section 199A. To address this uncertainty, the IRS also released Notice 2019-07 as a proposed version of a revenue procedure that included a safe harbor treating a rental real estate enterprise as a trade or business solely for purposes of section 199A.

Today’s revenue procedure was issued after the IRS and Treasury considered the comments received with regard to Notice 2019-07.

Safe harbor provided by Rev. Proc. 2019-38

Today’s revenue procedure sets forth the safe harbor and the procedural requirements for using it. “Relevant passthrough entities” (RPEs) may also use the safe harbor.

To use the safe harbor, taxpayers and RPEs must satisfy all of the requirements of Rev. Proc. 2019-38. As noted above, a failure to satisfy the requirements of the safe harbor does not preclude a taxpayer or the IRS from otherwise establishing that an interest in rental real estate is a trade or business for purposes of section 199A.

- Rev. Proc. 2019-38 defines certain terms including a “rental real estate enterprise” for purposes of the safe harbor as an interest in real property held for the production of rents and that 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 certain identified property interests, 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. 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 the safe harbor, 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 under section 199A.
- The determination to use this safe harbor must be made annually. For the purposes of section 199A, each rental real estate enterprise will be treated as a single trade or business if certain requirements are satisfied during the tax year with respect to the rental real estate enterprise:
 - Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise.
 - For rental real estate enterprises that have been in existence less than four years, 250 or more hours of rental services are performed per year. For other rental real estate enterprises, 250 or more hours of rental services are performed in at least three of the past five years.
 - The taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding the following: hours of all services performed; description of all services performed; dates on which such services were performed; and who performed the services.

- The taxpayer or RPE attaches a statement to the return filed for the tax year(s) the safe harbor is relied upon.

Effective date

Rev. Proc. 2019-38 applies to tax years ending after December 31, 2017.

Taxpayers and RPEs may rely on the safe harbor set forth in Notice 2019-07 for the 2018 tax year.

The contemporaneous records requirement will not apply to tax years beginning before January 1, 2020. However, the IRS has reminded taxpayers that they bear the burden of showing the right to any claimed deductions in all tax years.

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