

Clarification Issued for Tax Savings on Net Rental Income for Pass-Through Entities and Individuals

By Jennifer Pope

In our practice, we often encounter clients with rental properties as part of their asset portfolio. The DC metro area has a robust rental market and many savvy clients have chosen to engage in that market as landlords. The Tax Cuts and Jobs Act of 2017 added new provisions affecting the tax treatment of net rental income of pass-through entities. While many are familiar with the State and Local Tax (SALT) deduction changes and mortgage interest deduction caps that were enacted affecting homeowners, fewer are aware that wrapped up in the Tax Act are some safe harbor provisions for real estate investors that allow up to a 20% deduction of net rental income, whether or not they itemize deductions on their tax returns. Regulations were issued early in 2019 and just last week the IRS published further clarification.

On September 24th, 2019, the Internal Revenue Service issued Revenue Procedure 2019-38 (Rev. Proc. 2019-38) clarifying expanded rules for deductions allowed under Section 199A for rental properties owned by pass-through entities and individuals. The Service has more clearly defined what activities may be counted to reach the 250 hour threshold for trade or business activity and how to apply the threshold when the property is more than 4 years old. Owners may include activities performed by independent contractors and employees for time spent on maintenance, rent collection, and providing services to tenants but they may not include time spent arranging financing, acquiring properties, or travel. Additionally, a mixed-use property can now be considered a single business, rather than maintaining separate enterprises for residential and commercial activities. This change will help owners reach the participation thresholds for an active business.

Short story: If you have rental income that you report on your personal tax return, be sure to review these new guidelines with your tax advisor to see if you qualify for deductions against that income.