

# **BOTTOM LINE**

## **Your Tax Advocate**

January 21, 2019

On Friday, January 18<sup>th</sup> the IRS came out with guidance on claiming a Section 199A deduction on your return. Because some choices need to be implemented immediately, I wanted to make you aware of the changes now rather than wait for our appointment.

What is a Section 199A deduction? If your rental qualifies as a trade or business, it allows you to take up to 20% of your net rental profit to reduce your taxable income. If your taxable income is above \$157,500 (\$315,000 for married filing joint returns) there are complicated limitations. If your rentals have a net loss, there isn't a benefit to qualifying for this deduction. In fact, if your rental qualifies and you have a loss we would have to carry that loss forward to reduce any net rental profit the following year.

How is a rental trade or business defined? At first, the only definition we had was the rental had to rise to the level of a Section 162 trade or business. On Friday we finally got some guidance that gives us a safe harbor. If your rental meets the requirements below, it will be considered a Section 162 trade or business.

- Separate books and records are maintained for each rental activity (or the combined rentals if grouped together). Since you need to keep track of your income and expenses anyway, I don't see this being an issue.
- 250 hours or more of rental services are performed each year for the activity (or combined activity). That is an average of 20.83 hours per month or 4.81 hours per week. Rental services include advertising to rent, negotiating and executing leases, verifying tenant applications, collection of rent, daily operation and maintenance, management of the real estate, purchase of materials and supervision of employees and independent contractors. These hours do not need to be performed only by you. If you have a property manager their hours performing rental services can count too.
- You must ***contemporaneously*** maintain records including time reports or similar documents regarding 1) hours of all services performed, 2) description of all services performed, 3) date on which such services are performed and 4) who performed the service.

These are absolute requirements for 2019 tax year. Because you did not have this information for 2018, they are allowing you to reconstruct your time as best you can to make sure you have at least 250 hours.

Triple net leases are specifically excluded from qualifying even if you somehow meet all the above requirements. You are also specifically excluded if you use your rental as a personal residence for more than 14 days during the year.

If you have more than one rental we can make an election to combine them so you can meet the 250-hour test. Once we make this election, we cannot revoke it. We also cannot combine commercial and residential rentals.

If your rental qualifies for the Section 199A deduction, you are required to issue 1099s. In general, 1099s are required to be issued to anyone you pay over \$600 total for services. I have extra 1099s in my office if you need to issue any for 2018. They are due to the IRS and recipient by January 31 every year.

I hope this letter gives you enough time to decide if your rental qualifies for the Section 199A deduction for 2018. If it does, please immediately start keeping record of time spent on your rentals.

Sincerely,

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Enrolled Agent

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