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TAX REPORT

For Landlords, a New Tax Break Comes With Strings Attached

Property owners who want to claim a recently added 20% tax break for 2019 should plan now, because they may need to send 1099 forms early next year



ILLUSTRATION: KIERSTEN ESSENPREIS



By
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Rental real estate is renowned for its many tax breaks, and the 2017 tax overhaul added a new one. Landlords who want to claim it for 2019 should be planning now, because they may need to

send 1099 forms early next year.

The benefit is the so-called 199A deduction of 20%. It applies to business income—including rental income—earned by many sole proprietorships, limited-liability companies, partnerships and S corporations. These entities pass through profits and losses directly to their owners' individual tax returns, instead of paying tax at the corporate level.

Lots of Americans hold rental real estate in these types of firms. For 2017, about 20 million filers reported \$344 billion in rental income on Schedule E of their individual returns, according to Internal Revenue Service data cited by the National Apartment Association, an industry group.

Both taxpayers and advisers are confused about the new provision. Tony Nitti, a certified public accountant with RubinBrown in Denver, says that five days before the Oct. 15 tax-filing deadline, when preparers are often frantic, more than 200 people signed up for his seminar on the 199A deduction.

“Nearly two years after the law passed, people are still asking the most basic questions—like who gets it,” he says.

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The confusion is understandable. The 199A provision has added new layers of complexity to laws already chock-full of them.

Still, landlords should check out the new provision. Smaller landlords often have income below the threshold where some curbs on the tax break begin, which is taxable income below \$160,725 for single filers and \$321,400 for

married couples filing jointly in 2019. Landlords earning more could also benefit because of last-minute tweaks to the law in 2017, says Mr. Nitti.

Property owners who want to claim the 199A deduction for this year should pay attention now because key filing deadlines arrive early in 2020. Many tax preparers gave clients a pass on these deadlines on 2018 returns because the IRS hadn't issued final guidance.

“Now we know the rules, and the longer they are on the books, the less leeway tax preparers have,” says Jeffrey Porter, a CPA in Huntington, W.Va.

Here are issues for landlords to consider regarding the new deduction.

Profit or loss? The 199A deduction doesn't apply if rental owners have net losses from properties. Rental losses aren't always bad: Some buildings that are appreciating have paper

losses because of deductions for depreciation, interest, and other costs.

If there are losses, the owner might benefit instead by qualifying as a “real estate professional,” because those who do can deduct their losses against other income such as wages or capital gains. But the requirements are demanding, such as spending more than 750 hours and half of one’s working time on the real-estate business. Many would-be professionals fail the test.

Tax specialists say that with current low interest rates and longer depreciable lives, more rentals are showing profits.

“Trade or business”? To get the 199A deduction, the taxpayer’s rental income must be from a “trade or business” as determined by tax law.

This is a sticky issue, and 80 years of case law hasn’t resolved when rental real estate falls into this category, says James Hamill, a CPA with Reynolds Hix & Co. in Albuquerque, N.M. The firm has scores of clients who own rental real estate.

Confusing things further, the IRS released “safe harbor” guidance in late September detailing when the agency will automatically accept that rental real estate is a trade or business. But its hurdles are high.

“It’s essentially impossible for a landlord who owns a single property or two to qualify as a trade or business under the IRS’s safe harbor,” says Mr. Hamill.

Both Mr. Hamill and Mr. Nitti think case law provides ample justification for many rental owners, even small ones, to be in a trade or business outside the IRS’s safe harbor, even if they are employees of another business.

1099 forms. These forms are a key requirement for rental owners claiming the 199A deduction. The owner must issue them to providers of most services who charge \$600 or more that aren’t corporations and they must also send a copy to the IRS.

For example, 1099 forms are typically due if a plumber does separate jobs on your rental property adding up to \$750 in a year.

Landlords who want a 199A deduction for 2019 must send 1099s by Jan. 31, 2020. The penalty for not filing begins at \$50 for each form not sent by that date and rises steeply. For forms not sent by Aug. 1, the penalty is \$270 each.

Record-keeping. Landlords are sometimes casual about record-keeping. Owners who want a 199A deduction need to keep careful records and not commingle funds, specialists say. For landlords using the trade or business safe harbor, record-keeping requirements are stringent.

Personal use. Owners with substantial personal use of a property can't take the 199A deduction for it, so it's not available on the beach or lake home you sometimes rent out. Other tax rules apply to mixed-use vacation homes.

For these properties, don't forget one of the best tax freebies: People who rent their home for 14 or fewer days a year get to pocket the income from it tax-free.

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