

Rental Real Estate as Qualified Business Income

If you operate a rental real estate business, you may qualify to claim the business income deduction under Section 199A in one of two ways.

Qualified Business Income Deduction (QBID)

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. Individuals, estates and trusts can also deduct 20 percent of aggregate qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership income. The deduction is effective for tax years beginning after December 31, 2017, and before January 1, 2026.

The QBI deduction is calculated as the lesser of:

- combined qualified business income (up to 20% of qualified business income, plus 20% of REIT dividends and publicly traded partnership income); or
- 20% of the excess (if any) of taxable income over net capital gain.

In order to qualify for the deduction, the business must be a qualified trade or business which is defined as any trade or business other than a specified service trade or business (SSTB) or the trade or business of performing services as an employee.

Rentals meet the definition of a qualified trade or business in one of two ways:

- rentals to a commonly owned business; or
- under a safe harbor for certain rental real estate activities.

Rentals to a commonly owned business

A rental activity is treated as a qualified trade or business if it rents or licenses tangible or intangible property to a commonly owned trade or business. A business and a rental activity are commonly owned if the same person or group of persons directly or indirectly owns at least 50 percent of each of them. Businesses can meet this common-ownership test even if they are not otherwise eligible for aggregation.

Safe Harbor for Rental Real Estate Enterprise

Under a safe harbor, a rental real estate enterprise is treated as a trade or business for purposes of Section 199A only if:

- separate books and records are maintained to reflect income and expenses for each rental real estate enterprise;
- at least 250 hours of rental services are performed per year; and
- for tax years beginning after 2019, the taxpayer maintains sufficient contemporaneous records.