RENTAL OF RESIDENCES IN THE MODERN WORLD

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Reporting income from rental of a dwelling unit is not a one-tax-rule-fits-all

- IRC 183 Activities Not Engage in for Profit
- IRC 280A Rental of Vacation Homes
  - PMTA 2019-01 Interplay between the $10,000 limitation of §164(b)(6) and §280A(b)
- IRC 469 (General) Passive Activity Rules
- IRC 469(c)(7) Real Estate Professional Exception
- IRC 199A Qualified Business Income Deduction
  - NOTICE 2019-07 Real Estate Trade or Business Safe-Harbor
- IRC 162 Trade or Business Expenses...
- Characteristics of Carrying on a Trade or Business
IRC 183
Activities Not Engaged in for Profit

- How often does this situation occur?
- How about rental to family members at less than fair market value?

- If you don’t rent your property to make a profit, you can’t deduct rental expenses in excess of the amount of your rental income.
- No losses allowed
- No carryforwards

IRC 280(A) – Disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.

- There are three categories of usage that frame the general vacation home rental rules...

IRC 280(A) – Disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.

- What if the rental is less than 15 days a year?
- What if the owner restricts their usage to under 15 days a year?

- How do you figure rental expenses when the rental is only a portion of the personal residence or vacation home?
- What is personal use v. business use?
IRS advises that you limit your SALT...

- How do the SALT limitations rules affect the computation of vacation home rental and home office deductions?

- PMTA 2019-01
  Interplay between the $10,000 limitation of §164(b)(6) and §280A(b)

VARIATIONS ON VACATION RENTALS THANKS TO THE SHARING ECONOMY

Rules for Home Rentals

How it works

A community built on sharing

www.airbnb.com
Possible concerns of state and local governments:
- Business use in residentially zoned areas
- Unfair competition for hotels/motels
- Safety issues and increased need of local services
- Activities of visitors not same as owners/residents – noise, keeping the location neat and safe, etc.
- Reducing supply of long-term housing and increasing its cost
- Rent control issues – might tenant charge more than owner can charge?
- Failure of owners to pay taxes – TOT, business license, personal property taxes
- Need for simpler tax rules (at all levels)
- Illegal rentals / enforcement capabilities

Landlord considerations
- Is the rental legal in that city or county?
  - If yes, any restrictions to follow? Is registration required?
- Does any homeowner association contract allow the rental?
  - Is registration required with the HOA?
- Must owner or tenant have a business license (and pay a local tax)?
- Is transient occupancy tax (TOT) owed? How? Does the platform company handle that?
- Are personal property taxes owed?
  - Example – see San Francisco information

Can a vacation home rental activity actually be a business?
- What if your client purchases a residential unit to rent only to offer short-term rentals?
- When would a client get a 1099-K?
- What if there isn’t any third-party reporting of the rental?
- What state or local tax considerations should we be warning clients about who participate in the very short-term rental market?
When would a vacation home rental be presented on a Schedule C rather than a Schedule E?

- What constitutes "substantial services?"
- When would a rental property owner be subject to SE tax?

Rental real estate enterprise safe harbor

- Solely for the purposes of 199A, a safe harbor is available to individuals and owners of pass-through entities. Under the safe harbor a rental real estate enterprise will be treated as a trade or business for purposes of the QBI deduction. For more information on the safe harbor see Notice 2019-07.
- "Failure to satisfy the requirements of this safe harbor does not preclude a taxpayer from otherwise establishing that a rental real estate enterprise is a trade or business for purposes of section 199A."

My client only owns one or two rentals. Do 199A rules apply to her?

- Can a single rental activity constitute a "real estate enterprise" and be considered a trade or business?
- IRC 162 allows deductions for ordinary and necessary trade or business expenses
- …rules regarding the practical application of IRC 162 have evolved largely from case law and administrative guidance
My client owns multiple rentals, but they are mostly generating losses…

- Do I even have to think about the 199A issues if the properties are generating losses currently?
- What if they are producing income that is absorbed by prior year suspended losses?
- What can I do in presenting my clients information that will help support the presumption the properties are being conducted as a trade or business?
- Would filing 1099-MISC help?

How do the rental rules work differently if the owner is a “real estate professional”?

- …and California does not conform to this provision
- Nor does it conform to ANY of the TCJA provisions…yet

How do the 199A rules interact with the Net Investment Income rules of IRC 1411?

- Can I avoid the IRC 1411 rules by using the 199A rules because I believe my property qualifies as a IRC 162 business activity/real estate enterprise?
- NII distinguishes passive v. non-passive income
TOO MANY RULES SWIRLING INTO A VORTEX OF GO/NO-GO CONFUSION…

What planning can be considered for residential rentals to position them to take advantage of the 199A benefits?
- Using bonus depreciation? Section 179 expensing?
- De minimis safe harbor elections? Or Not?

Doing the Due Diligence…
- What questions should you be asking clients to know which category of rental activity they are conducting?
Vacation Home Rules: is the taxpayer subject to these rules?

Did the taxpayer use their rental unit for personal purposes during the year (include use by family members-other than those who paid a fair rental price, another co-owner OR anyone who uses the unit at less than a fair rental price)?

- **Yes**: Did the taxpayer rent out the unit for fewer than 15 days during the year?
  - **Yes**: The taxpayer does NOT have to include any of the rent in income, but CANNOT deduct any rental expenses. Mortgage interest, real estate tax and casualty losses on the unit should be included on Schedule A if the taxpayer itemizes.
  - **No**: The taxpayer IS subject to the vacation home deduction limitation rules. Rental expenses are limited. Expenses that are not deductible may be carried forward to a future year.
- **No**: The taxpayer is NOT subject to vacation home rules. The taxpayer may be subject to passive activity loss limitations and regular rental real estate rules may apply.

Did the taxpayer's personal use exceed the greater of 1) 14 days OR 2) 10% of the total days the unit was rented to others at a fair rental price?

- **Yes**: The taxpayer MUST allocate expenses between personal and rental days. Rental expenses in excess of rental income may be deductible but are subject to passive activity rules.
- **No**: The taxpayer does NOT have to include any of the rent in income, but CANNOT deduct any rental expenses. Mortgage interest, real estate tax and casualty losses on the unit should be included on Schedule A if the taxpayer itemizes.
Vacation Home Rental Worksheet - IRS Method

Name(s): 
Description of property: 
ID#: 
Tax Year: 

Dwelling Unit Used as Home (Use this module only if the answer is YES to all of the following questions.)
- Was the dwelling unit used as a home this year?
- Was the dwelling unit rented 15 days or more this year?
- Are the total rental expenses & depreciation more than the income?

Dividing Expenses Between Rental and Personal Use
- A) Number of days of rental use
- B) Number of days of personal use
- C) Number of days in tax year

Allocation Factors for Expenses
- D) IRS Method (line A/line A + line B)
- E) Tax Court Method for interest and taxes ONLY (line A/line C)

<table>
<thead>
<tr>
<th>IRS Method</th>
<th>Operating Expenses</th>
<th>Excess Mortgage Interest</th>
<th>Excess Mortgage Insurance Premiums</th>
<th>Excess Casualty/Theft Losses</th>
<th>Depreciation as if 100% Rental</th>
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1. Rents received
2. a. Rental portion of deductible mortgage interest
   - Rental portion of deductible mortgage insurance premiums
   - Rental portion of real estate taxes
   - Rental portion of deductible casualty and theft losses
   - Direct rental expenses
   - Fully deductible RENTAL EXPENSES
3. Subtract line 2e from line 1. If zero or less, then zero
4. a. Rental portion of expenses related to operating or maintaining the dwelling unit (such as repairs insurance, and utilities)
   - Rental portion of excess mortgage interest
   - Rental portion of excess mortgage insurance premiums
   - Carryover of Operating Expenses (prior year)
   - Add lines 4a - 4c
   - Allowable OPERATING EXPENSES
5. Subtract line 4e from line 3. If zero or less, then zero
6. a. Rental portion of excess casualty and theft losses
   - Rental portion of depreciation of the dwelling unit
   - Carryover of excess casualty and theft losses and depreciation (prior year)
   - Add lines 6a - 6c
   - Allowable EXCESS CASUALTY and THEFT LOSSES and DEPRECIATION
5. Smaller of line 5 or line 6d
7. a. Operating expenses to be carried over to next year
   b. Excess casualty and theft losses and depreciation to be carried over to next year. Subtract line 6e from line 6d

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