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Rent From Yourself? The Tax and SBA Rules When Your LLC Owns Your Business's Building

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Leasing your building to your own business? Why the rent isn't passive income, what counts as fair rent, depreciation limits and the SBA's property-company rules, plus a checklist.

About this article: BlackRefer Insights are researched and written by the BlackRefer Editorial Team from primary sources, including statutes, regulations, IRS publications, court opinions and SBA rules, which are linked in the notes. We don't sell legal, tax or lending services, and we have no relationship with any lender or firm mentioned here.

Not legal, tax, accounting or financial advice. This article is general education about federal rules as of November 16, 2026. State law, your entity type and your loan documents can change the answer. Before you set up a property company, sign a lease with your own business or apply for an SBA loan, work through it with your attorney and your CPA.

If you want to own the building your business operates in, a common approach is to put the real estate in one company, often an LLC, and have that company lease the space to your operating business. You're the landlord and, in effect, the tenant. The business pays rent, the property company collects it, and the building sits in a separate entity from the business.

That structure can make sense, but some of the advice around it is wrong in ways that cost money. Here's what the tax code, the courts and the SBA say, and what to ask your attorney and CPA before you sign anything.

The short version: what renting to yourself does not do

Start with a common misunderstanding. **Rent your business pays to a property company you own generally does not create passive income.** Rental income is normally passive under the tax code, so many owners assume rent from their own business is passive too, and that it can absorb passive losses from other investments. Under the self-rental rule, it generally can't.

IRS Publication 925 states it directly: "If you rent property to a trade or business activity in which you materially participated, net rental income from the property is treated as nonpassive income." 1 The rule in the regulations is known as recharacterization. 2 And it works in only one direction. The net income from the

building is recharacterized as nonpassive, but a net loss on the same building is treated like any other loss from that type of activity, which for a rental generally means it stays passive. 1

So if someone pitches "rent from yourself" as a way to turn business profit into passive income, that's not how the rule works. Take any plan that depends on it to your CPA first.

1. The self-rental rule, up close

General information only. Passive-activity planning is fact-specific; do this with your CPA.

What the regulation says. Treasury Regulation §1.469-2(f)(6) treats net rental income from an item of property as "not from a passive activity" if the property is rented for use in a trade or business "in which the taxpayer materially participates." 2 Owners who run their business day to day often meet that participation test, which is why the rule catches them.

It applies property by property. In Carlos v. Commissioner (2004), the taxpayers rented one building to their steel company, which produced net income of about $102,000 a year, and another to their restaurant, which produced a net loss of about $41,000 a year. They netted the two. The Tax Court said no: the regulation "explicitly re-characterizes net rental activity income from an 'item of property' rather than net income from the entire rental 'activity.'" The profitable building's income was nonpassive, and the losing building's loss "retains its characterization as loss from a passive activity," so it was disallowed. 3 Those figures are that case's facts, not benchmarks. The lesson is that a profitable self-rental can't automatically shelter a losing one.

Courts have upheld it. In Fransen v. United States (5th Cir. 1999), the court summarized the rule ("when a taxpayer rents property to his own business, the income is not passive activity income") and held it "a valid interpretation of § 469." The rule applied even though the tenant was a C corporation, and it reached the spouse who didn't work in the business. 4

A note on Loper Bright, for the curious. Fransen relied on Chevron deference, the doctrine that courts defer to an agency's reasonable reading of a statute. The Supreme Court overruled Chevron in Loper Bright Enterprises v. Raimondo (2024). The Court also said it does "not call into question prior cases that relied on the Chevron framework," and that the holdings of those cases "are still subject to statutory stare decisis." 5 Our reading is that Fransen's holding still stands, though a new challenge to the regulation in another circuit couldn't rely on Chevron. Loper Bright didn't strike down the self-rental rule, and nothing in our sources suggests it's going away. **Plan as if the rule applies,** and leave any litigation theory to your tax attorney.

The narrow exception: grouping. Some owners can group the rental with the business and treat them as one activity. The regulation allows this only if the two form an appropriate economic unit and the rental is insubstantial relative to the business, the business is insubstantial relative to the rental, or "each owner of the trade or business activity has the same proportionate ownership interest in the rental activity." 6 Once you group activities, you generally "may not regroup those activities in subsequent taxable years," except in limited cases. 6 Grouping also has to be disclosed. Revenue Procedure 2010-13 requires a written

statement with the original return for the first year of grouping. If you fail to report it, each activity "will be treated as a separate activity," though there's a relief provision for late discovery. 7

One practical consequence: if you bring in a partner on the building who doesn't own the business in the same proportion, or the reverse, you may lose the option to group. **Discuss ownership splits with your attorney and CPA before you form either entity.**

Two related rules to raise with your CPA.

• **Net investment income tax.** The 3.8% net investment income tax 8 has a matching rule. Rental income treated as nonpassive under the self-rental rule, or through grouping, "is deemed to be derived in the ordinary course of a trade or business." 9 That's one step in the analysis, not the final answer. Whether the income avoids the tax also depends on the business itself, so don't assume it's exempt.

• **The QBI deduction.** For the qualified business income deduction, a rental that wouldn't otherwise count as a trade or business is "nevertheless treated as a trade or business" if it's rented to a commonly controlled business. 10 As of November 16, 2026, the 2025 tax law (P.L. 119-21) removed the provision that would have ended the deduction after 2025. 11 Ask your CPA how it applies to your structure.

2. The rent has to be fair, and the IRS checks

Rent is deductible for property your business uses but doesn't own. 12 That's the basic reason the structure works for taxes: the operating company deducts the rent, and the property company reports it as income. But the deduction has a limit.

In Plentywood Drug, Inc. v. Commissioner (2021), the Tax Court explained that "for an expense like rent to be ordinary and necessary, it must also be reasonable in amount," and "any part of rent that is unreasonable is not ordinary and necessary and thus not deductible." The IRS "does sometimes look closely to the fairness of rent charged when landlord and tenant might not have an incentive to drive a hard bargain." 13 Renting to yourself fits that description.

In a C corporation, excess rent can become a dividend. When a C corporation pays its owners something it calls rent, but "the economic reality is that it's a distribution of profits," the court explained, "the seemingly deductible expense is actually a nondeductible dividend," a "constructive" dividend that the owners must include in income. 13 That means the corporation loses the deduction for the excess, and the owners still pay tax on it. In Plentywood, the IRS disallowed part of the rent a drugstore corporation paid its owners and treated the excess as constructive dividends. The court found that "the fair rent for all three years was $171,187.50," and that in 2012 and 2013 the corporation "did overpay its rent by about $20,000." No penalties applied, partly because the owners had relied on appraisers and "reached a reasonable result in good faith." 13 Those are that case's facts, not a benchmark.

The takeaway is documentation. Rent should be defensible as fair market. Fair rent usually comes from comparable leases nearby or an appraiser's opinion. There's no reliable shortcut formula. Get a written opinion when you set the rent, keep it with your lease, and revisit it when the lease renews or the market

changes. **Have your CPA review the number before the first payment.**

3. Depreciation: three clocks

As of November 16, 2026. Some guidance is interim; confirm with your CPA.

When the property company buys a building, the purchase price has to be split, and each piece follows a different schedule.

• **Land: no depreciation.** "You cannot depreciate the cost of land because land does not wear out, become obsolete, or get used up." 14 How the price is divided between land and building affects every year's deductions, so it's a CPA question from day one.

• **The building: 39 years.** Nonresidential real property is depreciated over 39 years. 15

• **Interior improvements: possibly 15 years, and possibly bonus depreciation.** Improvements to the interior of a commercial building, made after the building was first placed in service, can be "qualified improvement property," which the tax code lists as 15-year property. Enlargements, elevators and escalators, and the internal structural framework are excluded. 15

Bonus depreciation can apply to qualifying improvements, not the building itself. As of November 16, 2026, the 2025 tax law provides "a permanent 100 percent additional first year depreciation deduction for qualified property acquired and placed in service... after January 19, 2025," according to IRS Notice 2026-11, which is interim guidance; proposed regulations have been announced but aren't final. 16 Qualified property generally has "a recovery period of 20 years or less." 15 Our reading of that statute is that a 39-year building falls outside the limit, while 15-year qualified improvement property falls inside it. That follows from the statute's text, but it's not a sentence the IRS has written, so confirm it with your CPA. In plain terms: some improvements may qualify for faster write-offs, but the building itself is depreciated over 39 years. If anyone tells you bonus depreciation lets you write off the whole building, get a second opinion.

Moving a building you already own into a new LLC can raise its own tax questions. That's another reason to **talk to your CPA before you retitle anything.**

4. Buying the building with SBA help: the EPC rules

As of November 16, 2026. The SBA's current rulebook is SOP 50 10 8.1, effective October 1, 2026. 17 Confirm the current rules with your lender.

The SBA generally doesn't finance assets held for passive income. But it has an exception built for this structure. An **Eligible Passive Company (EPC)**, the property-holding company, can borrow to buy real estate it leases to an **Operating Company (OC)**, the business. 18 The SBA interprets each condition strictly. If the conditions aren't met and a 7(a) loan defaults, the SBA may deny liability on its guaranty. That's a risk your lender will care about. 17

The conditions in the regulation include: 18

- **A written lease** that is "subordinate to SBA's mortgage."
- **An assignment of all rents** to the lender as collateral.
- **A rent cap.** Rent "cannot exceed the amount necessary to make the loan payment to the lender, and an additional amount to cover the Eligible Passive Company's direct expenses of holding the property, such as maintenance, insurance and property taxes."
- **A lease at least as long as the loan.** The lease, "including options to renew exercisable solely by the Operating Company, must have a remaining term at least equal to the term of the loan."
- **Guarantees.** The operating company must be a guarantor or co-borrower, and "each holder of an ownership interest constituting at least 20 percent of either the Eligible Passive Company or the Operating Company must guarantee the loan."

Occupancy rules. For an existing building, the business must "permanently occup[y] and use[] no less than 51 percent" of the rentable property and may lease out up to 49%. For new construction, it must occupy at least 60%, may permanently lease up to 20%, and must plan to occupy some of the rest within three years and all of it within ten. When an EPC leases the whole building to operating companies, they must together meet the same rules. 19 The SBA's SOP adds that the business has no more than one year to meet occupancy requirements. 17

Loan size. As of November 16, 2026, the SBA states that "the maximum loan amount for a 7(a) loan is $5 million." 20 The SBA's 504 program is also used for real estate. Confirm its current maximum with your lender or the SBA, because the SBA's own 504 page gives two different figures.

5. Two referees, one rent: a question for your CPA

The **IRS** wants rent that's reasonable and arm's-length, and the court cases we found concern rent that was set too high. 13 The **SBA**, for an EPC loan, caps rent at debt service plus the property company's direct holding costs. 18 Depending on your loan terms and local market, the SBA's cap could come out below fair-market rent.

We found no IRS guidance or court case addressing below-market rent set by an SBA cap. It may or may not be a problem. It's an open question for your specific facts. **If you're financing with an SBA EPC loan, ask your CPA directly: how do the SBA rent cap and the IRS fair-rent rules fit together for us, and how should we document the rent?** Have your attorney check that the lease satisfies the SBA conditions at the same time.

6. The separate LLC is not a force field

Liability protection is a common reason to hold the building in a separate entity. State LLC laws generally provide that members aren't personally liable for the company's debts just by being members. Delaware's statute, for example, says the LLC's debts "shall be solely the debts, obligations and liabilities of the limited liability company," and no member is personally obligated "solely by reason of being a member." 21 Other states have their own versions, so check yours with your attorney.

Two things can undo that protection:

• **Personal guarantees.** If you personally guarantee the loan, and SBA EPC loans require it from every 20%-or-greater owner, 18 the LLC doesn't protect you from that debt.

• **Not keeping the entities separate.** A California State Bar business law article describes how courts can disregard an LLC when "there is such a unity of interest and ownership" that its separateness "has ceased," and honoring it would "sanction a fraud or promote injustice." It lists factors including commingling of assets, failure to maintain records and undercapitalization. 22 Treat that as one state's framework. For a two-entity setup, the basics are a real written lease, rent actually paid on schedule, and separate bank accounts and books for the property company and the operating company.

A hypothetical walk-through

This is a fictional example, not a real business or a recommendation. Picture a family-owned bakery that wants to buy the building it rents. The owner forms a property LLC and plans an SBA EPC loan. Here's the order the conversations would happen in:

1. **The attorney** reviews the entity structure, the ownership split between the two companies (which affects grouping), the lease and the guarantees.

2. **The CPA** explains that the rent the property LLC collects will generally be nonpassive, so it won't absorb the owner's passive losses from other investments. The CPA also allocates the price between land and building and identifies which planned interior work might be qualified improvement property.

3. **An appraiser or broker** provides a written fair-rent opinion.

4. **The lender** confirms the SBA rent cap, the lease term, occupancy and guarantee requirements.

5. **The CPA and attorney together** reconcile the SBA's rent cap with the fair-rent opinion and document how the rent was set.

The owner might go ahead, change the structure, or decide to keep renting. Any of those can be the right answer if it's reached this way.

The bottom line

Holding your building in a separate company can be a sound structure, but it's not a tax shelter. Renting to yourself generally doesn't create passive income, the rent has to be fair, the building itself isn't bonus-depreciable, and an SBA loan adds its own rules on rent, occupancy and guarantees. Many owners hold real estate in a separate entity, but whether it helps you depends on your state, your lender and your taxes. Write it down, document the rent, keep the entities separate, and **do this with your attorney and CPA.**

Companion: Rent-From-Yourself Readiness Checklist

General education, not legal or tax advice. Work through every item with your attorney and CPA.

1. **Test the reason.** Write down why you want a separate property company (liability, financing, succession). If the reason is "passive income," stop: rent from your own business generally isn't passive income.

2. **Decide the ownership split with both advisors.** Unequal ownership between the property company and the business can block grouping and affect guarantees.

3. **Ask your CPA about grouping.** If it's available and you choose it, make sure the Rev. Proc. 2010-13 statement goes with the first return. Remember it's generally permanent.

4. **Get a written fair-rent opinion** from an appraiser or broker using comparable leases, and keep it with the lease.

5. **Sign a real written lease** covering term, rent, payment dates, maintenance, insurance and taxes. If it's an SBA loan, the lease must be subordinate to the SBA mortgage and run at least as long as the loan.

6. **Reconcile the two rent rules.** If you use an SBA EPC loan, ask your CPA how the SBA rent cap fits with IRS fair-rent rules, and document the answer.

7. **Allocate land vs. building** with your CPA, and identify planned interior work that may qualify as 15-year improvement property, confirming bonus depreciation eligibility as of the date you place it in service.

8. **Talk to your CPA before retitling** an existing building into a new LLC. Related-party rules can limit depreciation.

9. **Confirm SBA eligibility with your lender:** occupancy (51% existing, 60% new construction), assignment of rents, guarantees from every 20%+ owner of either company, and current loan caps.

10. **Keep the entities separate:** separate bank accounts, separate books, rent paid on schedule, and no commingled expenses.

11. **Review your insurance setup** with your agent and attorney: who insures the building, who insures contents, and how each company is named.

12. **Calendar the reviews:** revisit the rent and documentation at each renewal and whenever the market or your loan changes.

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