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# Self-Rental Tax Delimmas – Are you in Danger?

Presented by:

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# What is a Self-Rental?



- The property owner materially participates in the entity renting the property
  - Income reclassified as non-passive
  - Losses remain passive
  - Credits remain passive
  - Activities remain passive





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# Introduction – Tax Reform Act 1986

- Creation of IRC §469
  - §469(a) - Passive losses no longer deductible
  - §469(b) – Losses carried over to future years





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# Tax Reform Act 1986



- §469(c) - Passive Activities Defined
  - Any Activity Lacking Material Participation
  - Any Rental Activity





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# Tax Reform Act 1986



- §469(c)(6) – Connected to a Trade or Business
- §469(h) – Material Participation Defined
- §469(l) – IRS gets to write the rules - Legislative Regulations Authorized



# Code §482



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- Allocation of income and deductions among taxpayers
  - In any case of two or more organizations..... owned or controlled directly or indirectly by the same interests,





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# Code §482



- Allocation of income and deductions among taxpayers
  - The Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses.



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# The Self Rental Rule



- Treasury Regulation §1.469-2(f)(6)
  - Property rented to a nonpassive activity. An amount of the taxpayer's gross rental activity income for the taxable year... is treated as not from a passive activity ...



# The Self Rental Rule



continued...

- if the property –
  - (i) Is rented for use in a trade or business activity
  - in which the taxpayer materially participates
  - §1.469–5T, yes still temporary

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# Review of Concepts



- Self-Rental Rule – If the shoe fits, wear it
  - Material Participation
  - Legislative vs. Interpretive Regulations
  - Item of Property



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# Review of Concepts



- Self-Rental Rule – If the shoe fits, wear it (yes, there's more)
  - Non-passive income is a separate type
  - Re-characterizations / Allocations





# Tax Risk #1



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- Income from self-rentals cannot be orchestrated to be offset by net losses from other passive activities





# Tax Risk #2



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- The netting of profits and losses from self-rentals is not allowed





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# Tax Risk #3

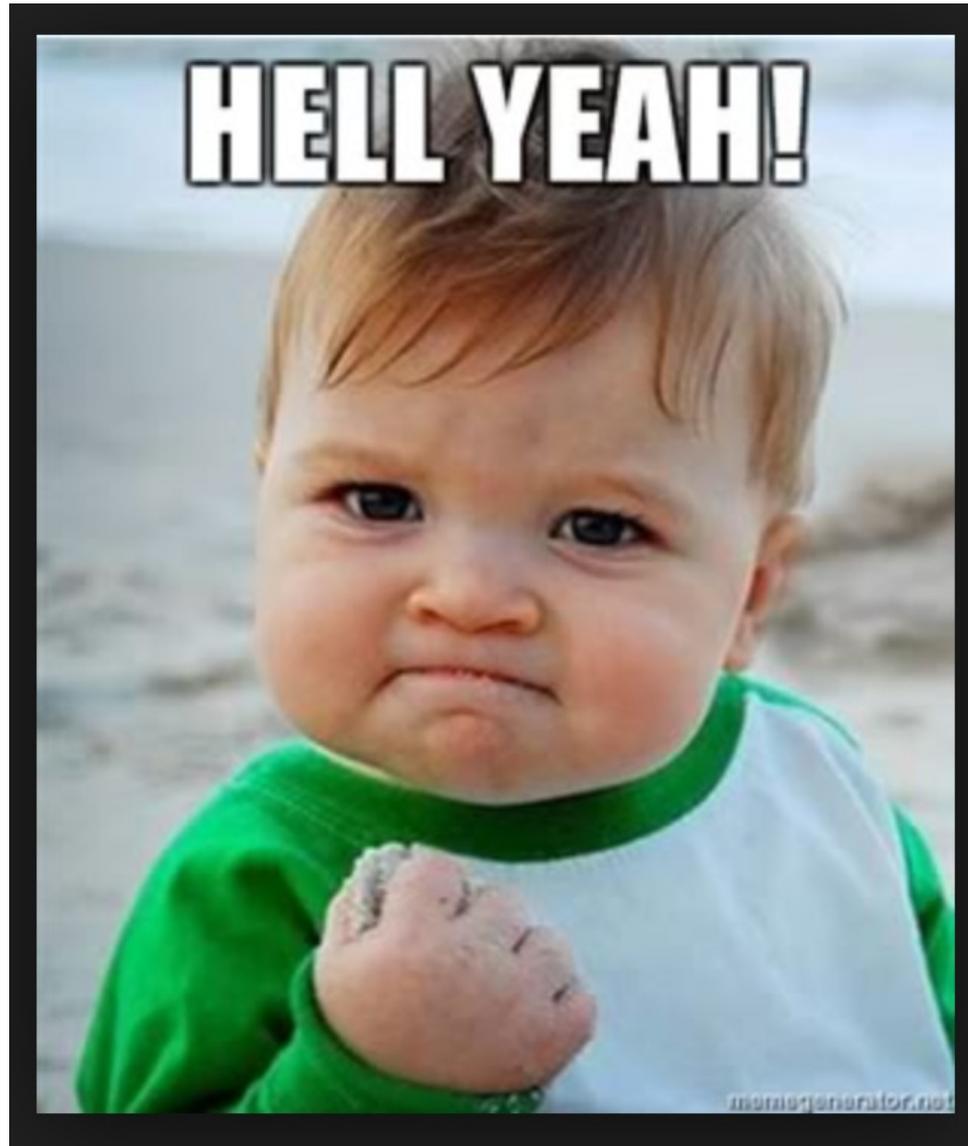


- Income in excess of market rents from self-rentals can be re-characterized as dividend distribution income
- What about less than fair market rent?



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# Tax Risk #4



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- Limits passive activity credits
- The self-rental rule only re-characterizes the income as non-passive





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# Tax Risk #5



- For purposes of the earned income credit, nonpassive self-rental income remains disqualifying investment income





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# Tax Risk #6



- Self-rental income is not portfolio income
  - not available as a source of investment income
  - no deduction of investment interest expense on Form 4952



# Tax Risk #7



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- If an S-Corporation pays rent to an employee for the employee's home office, the activity is classified as a self-rental under the rule





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# Risk Conclusion



- The self-rental rule is constitutional, was properly established and accurately reflects the legislative intent of Congress.



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# Risk Conclusion



- The self-rental rule applies only to the income from an item of property and not to a loss and not to the activity itself.





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# Risk Conclusion



- The reclassification of the self-rental income does not reclassify credits generated by the activity and is not applicable to other sections of the tax code.



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# For More Information

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More information is available including additional materials at:

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Or Table in Lobby

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