Self-Rental Tax Delimmas
- Are you in Danger?

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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
Introduction –
Tax Reform Act 1986

• Creation of IRC §469
  – §469(a) - Passive losses no longer deductible
  – §469(b) – Losses carried over to future years
Tax Reform Act 1986

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

• 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,
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.
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
Review of Concepts

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

• Income from self-rentals cannot be orchestrated to be offset by net losses from other passive activities
Tax Risk #2

- The netting of profits and losses from self-rentals is not allowed
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?
Tax Risk #4

- Limits passive activity credits
- The self-rental rule only re-characterizes the income as non-passive
Tax Risk #5

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

• 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
Risk Conclusion

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

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More information is available including additional materials at:
Booth in Vendor Hall
Or Table in Lobby
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