

The Real Estate Professional: Exception to the Passive Activity Loss Rules

Speakers

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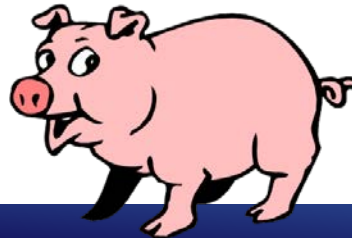


IRC 469 Passive Activity Loss Limitations

- General Rule: **PALs** not allowed



- Suspended & *carried forward* indefinitely
- **PALs** offset against passive income generator (**PIG**)



IRC 469 Issues

- *Passive* Activity defined
- Material Participation
- Grouping Activities
- Releasing losses through dispositions
- Modified AGI defined
- Married Filing Separately



Special \$25,000 Allowance

- Natural person
- **10%** ownership at all time during tax year
- “Active” Participation
- Modified **AGI** limitation



Real Estate Professional Exception

- The Special \$25,000 Allowance Limitation **does not apply**: can have *more than \$25,000* of active real estate losses
- **\$100,000** Modified AGI test **does not apply**
- **\$100,000-\$150,000** *phase-out rules* **do not apply**



Real Estate Professional Qualification

- **Material** participation in **each** specific rental
- **Material** participation in **separate** Real Property Trade or business
 - 50% rule
 - 750 hours rule
 - 5% ownership rule



Real Estate Trade or Business Defined

IRC Sec. 469(c)(7)(C) *Any Real Property:*

- Development or redevelopment;
- Construction or reconstruction;
- Acquisition and/or conversion;
- Rental Activity that is not a Passive Activity;
- Property management;
- Brokerage activities.



Example – Laura

- Owns **5% or more** of a real estate sales office
- Works full time as a broker
- She owns 3 rental properties and:
 - She finds the tenants;
 - Approves tenants and leases;
 - Approves and oversees repairs & improvements
- Net rental losses are **\$31,000** and her modified AGI is **\$160,000** before the losses
- Deduct the full **\$31,000** in the current tax year



Example – John

- John acquires old homes and contracts 3rd parties to renovate and ready for resale. John is a single member LLC and files a Schedule C as a real estate trade or business. This is his main source of income.
- He owns 2 rental properties that generate (\$28,000) of losses in which he materially participates in the management: his modified AGI is \$175,000 before the losses. Since he is a real estate professional the **\$25,000 limitation** and modified AGI tests do not apply.



Tax Court Ruling

Agarwal vs Commissioner

- **T.C. Summary Opinion 2009-29:** Real estate Agent; Sole-proprietor Schedule C; filed as a Real Estate Professional (real estate sales license)
- Losses claimed were \$40,000 and AGI was in excess of \$150,000
- Issue of the common use of the term “brokerage”



Tax Court Ruling

Bahas vs Commissioner

- **T. C. Summary Opinion 2010-115:** Employee of a real estate office also a licensed real estate sales person
- W-2 earnings included 6% share of corporate profits
- Rental losses exceeded \$25,000 and AGI exceeded \$150,000. She filed as a Real Estate Professional
- IRS denied under 5% ownership rule
- Court concurred



Research, Reference & more Information

- IRS Audit Techniques Guide (ATG)
- Pub. 925 Passive Activity and At-Risk Rules
- Pub. 527 Residential Rental Property
- Instructions for Schedule E Form 1040
- **Come to the NSTP booth in the Exhibit Hall and NSTP table in main corridor**

