Internal Revenue Service, Treasury

§ 1.469–9

or J’s income for the taxable year from interest charged to Y ($8,000). Thus, J’s applicable percentage is 25 percent ($2,000/$8,000), and $2,000 of J’s income from interest charged to Y is treated as passive activity gross income from the passive trade or business activity J conducts through Y.

[T.D. 9013, 67 FR 54089, Aug. 21, 2002]

§ 1.469–8 Application of section 469 to trust, estates, and their beneficiaries. [Reserved]

§ 1.469–9 Rules for certain rental real estate activities.

(a) Scope and purpose. This section provides guidance to taxpayers engaged in certain real property trades or businesses on applying section 469(c)(7) to their rental real estate activities.

(b) Definitions. The following definitions apply for purposes of this section:

(1) Trade or business. A trade or business is any trade or business determined by treating the types of activities in § 1.469–4(b)(1) as if they involved the conduct of a trade or business, and any interest in rental real estate, including any interest in rental real estate that gives rise to deductions under section 212.

(2) Real property trade or business. Real property trade or business is defined in section 469(c)(7)(C).

(3) Rental real estate. Rental real estate is any real property used by customers or held for use by customers in a rental activity within the meaning of § 1.469–1T(e)(3). However, any rental real estate that the taxpayer grouped with a trade or business activity under § 1.469–4(d)(1)(i)(A) or (C) is not an interest in rental real estate for purposes of this section.

(4) Personal services. Personal services means any work performed by an individual in connection with a trade or business. However, personal services do not include any work performed by an individual in the individual’s capacity as an investor as described in § 1.469–5T(b)(2)(ii).

(5) Material participation. Material participation has the same meaning as under § 1.469–5T. Paragraph (f) of this section contains rules applicable to limited partnership interests in rental real estate that a qualifying taxpayer elects to aggregate with other interests in rental real estate of that taxpayer.

(6) Qualifying taxpayer. A qualifying taxpayer is a taxpayer that owns at least one interest in rental real estate and meets the requirements of paragraph (c) of this section.

(c) Requirements for qualifying taxpayers—(1) In general. A qualifying taxpayer must meet the requirements of section 469(c)(7)(B).

(2) Closely held C corporation. A closely held C corporation meets the requirements of paragraph (c)(1) of this section by satisfying the requirements of section 469(c)(7)(D)(i). For purposes of section 469(c)(7)(D)(i), gross receipts do not include items of portfolio income within the meaning of § 1.469–2T(c)(3).

(3) Requirement of material participation in the real property trades or businesses. A taxpayer must materially participate in a real property trade or business in order for the personal services provided by the taxpayer in that real property trade or business to count towards meeting the requirements of paragraph (c)(1) of this section.

(4) Treatment of spouses. Spouses filing a joint return are qualifying taxpayers only if one spouse separately satisfies both requirements of section 469(c)(7)(B). In determining the real property trades or businesses in which a married taxpayer materially participates (but not for any other purpose under this paragraph (c)), work performed by the taxpayer’s spouse in a trade or business is treated as work performed by the taxpayer under § 1.469–5T(f)(3), regardless of whether the spouses file a joint return for the year.

(5) Employees in real property trades or businesses. For purposes of paragraph (c)(1) of this section, personal services performed during a taxable year as an employee generally will be treated as performed in a trade or business but will not be treated as performed in a real property trade or business, unless the taxpayer is a five-percent owner (within the meaning of section 416(1)(1)(B)) in the employer. If an employee is not a five-percent owner in the employer at all times during the taxable year, only the personal services performed by the employee during the period the employee is a five-percent
owner in the employer will be treated as performed in a real property trade or business.

(d) General rule for determining real property trades or businesses—(1) Facts and circumstances. The determination of a taxpayer’s real property trades or businesses for purposes of paragraph (c) of this section is based on all of the relevant facts and circumstances. A taxpayer may use any reasonable method of applying the facts and circumstances in determining the real property trades or businesses in which the taxpayer provides personal services. Depending on the facts and circumstances, a real property trade or business consists either of one or more than one trade or business specifically described in section 469(c)(7)(C). A taxpayer’s grouping of activities under §1.469–4 does not control the determination of the taxpayer’s real property trades or businesses under this paragraph (d).

(2) Consistency requirement. Once a taxpayer determines the real property trades or businesses in which personal services are provided for purposes of paragraph (c) of this section, the taxpayer may not redetermine those real property trades or businesses in subsequent taxable years unless the original determination was clearly inappropriate or there has been a material change in the facts and circumstances that makes the original determination clearly inappropriate.

(e) Treatment of rental real estate activities of a qualifying taxpayer—(1) In general. Section 469(c)(2) does not apply to any rental real estate activity of a taxpayer for a taxable year in which the taxpayer is a qualifying taxpayer under paragraph (c) of this section. Instead, a rental real estate activity of a qualifying taxpayer is a passive activity under section 469 for the taxable year unless the original determination was clearly inappropriate or there has been a material change in the facts and circumstances that makes the original determination clearly inappropriate.

(2) Treatment as a former passive activity. For any taxable year in which a qualifying taxpayer materially participates in a rental real estate activity, that rental real estate activity will be treated as a former passive activity under section 469(f) if disallowed deductions or credits are allocable to the activity under §1.469–1(f)(4).

(3) Grouping rental real estate activities with other activities—(i) In general. For purposes of this section, a qualifying taxpayer may not group a rental real estate activity with any other activity of the taxpayer. For example, if a qualifying taxpayer develops real property, constructs buildings, and owns an interest in rental real estate, the taxpayer’s interest in rental real estate may not be grouped with the taxpayer’s development activity or construction activity. Thus, only the participation of the taxpayer with respect to the rental real estate may be used to determine if the taxpayer materially participates in the rental real estate activity under §1.469–5T.

(ii) Special rule for certain management activities. A qualifying taxpayer may participate in a rental real estate activity through participation, within the meaning of §§1.469–5(f) and 5T(f), in an activity involving the management of rental real estate (even if this management activity is conducted through a separate entity). In determining whether the taxpayer materially participates in the rental real estate activity, however, work the taxpayer performs in the management activity is taken into account only to the extent it is performed in managing the taxpayer’s own rental real estate interests.

(4) Example. The following example illustrates the application of this paragraph (e).
Example. (1) Taxpayer B owns interests in three rental buildings, U, V and W. In 1996, B has $30,000 of disallowed passive losses allocable to Building U and $10,000 of disallowed passive losses allocable to Building V under §1.469–1(f)(4). In 1996, B has $5,000 of net income from Building U, $5,000 of net losses from Building V, and $10,000 of net income from Building W. Also in 1996, B is a qualifying taxpayer within the meaning of paragraph (c) of this section. Each building is treated as a separate activity of B under paragraph (e)(1) of this section, unless B makes the election under paragraph (g) to treat the buildings as a single activity, all participation relating to the buildings is aggregated in determining whether B materially participates in the combined activity.

(ii) Effective beginning in 1996, B makes the election under paragraph (g) to treat the three buildings as a single rental real estate activity. If the buildings are treated as separate activities, material participation is determined separately with respect to each building. If B makes the election under paragraph (g) to treat the buildings as a single activity, all participation relating to the buildings is aggregated in determining whether B materially participates in the combined activity.

(f) Limited partnership interests in rental real estate activities. (1) In general. If a taxpayer elects under paragraph (g) of this section to treat all interests in rental real estate as a single rental real estate activity, and the taxpayer’s share of gross rental income from all of the taxpayer’s limited partnership interests in rental real estate is less than ten percent of the taxpayer’s share of gross rental income from all of the taxpayer’s interests in rental real estate for the taxable year, paragraph (f)(1) of this section does not apply. Thus the taxpayer may determine material participation under any of the tests listed in §1.469–5T(a) that apply to rental real estate activities.

(2) De minimis exception. If a qualifying taxpayer elects under paragraph (g) of this section to treat all interests in rental real estate as a single rental real estate activity, and the taxpayer’s limited partnership interests in rental real estate are treated as separate activities, material participation is determined separately with respect to each activity. Because Buildings U, V and W are treated as one activity for all purposes of section 469 due to the election under paragraph (g), and this activity is a former passive activity under section 469(f), B may offset the $10,000 of net income from the buildings with an equal amount of disallowed passive losses allocable to the buildings, regardless of which buildings produced the income or losses. As a result, B has $30,000 ($40,000 – $10,000) of disallowed passive losses remaining from the buildings after 1996.
(2) Certain changes not material. The fact that an election is less advantageous to the taxpayer in a particular taxable year is not, of itself, a material change in the taxpayer’s facts and circumstances. Similarly, a break in the taxpayer’s status as a qualifying taxpayer is not, of itself, a material change in the taxpayer’s facts and circumstances.

(3) Filing a statement to make or revoke the election. A qualifying taxpayer makes the election to treat all interests in rental real estate as a single rental real estate activity by filing a statement with the taxpayer’s original income tax return for the taxable year. This statement must contain a declaration that the taxpayer is a qualifying taxpayer for the taxable year and is making the election pursuant to section 469(c)(7)(A). The taxpayer may make this election for any taxable year in which section 469(c)(7) is applicable. A taxpayer may revoke the election only in the taxable year in which a material change in the taxpayer’s facts and circumstances occurs or in a subsequent year in which the facts and circumstances remain materially changed from those in the taxable year for which the election was made. To revoke the election, the taxpayer must file a statement with the taxpayer’s original income tax return for the year of revocation. This statement must contain a declaration that the taxpayer is revoking the election under section 469(c)(7)(A) and an explanation of the nature of the material change.

(h) Interests in rental real estate held by certain pass-through entities—(1) General rule. Except as provided in paragraph (h)(2) of this section, a qualifying taxpayer’s interest in rental real estate held by a partnership or an S corporation (pass-through entity) is treated as a single interest in rental real estate if the pass-through entity grouped its rental real estate into separate rental activities under §1.469–4(d)(5). If the pass-through entity grouped its rental real estate into separate rental activities under §1.469–4(d)(5), each rental real estate activity of the pass-through entity will be treated as a separate interest in rental real estate of the qualifying taxpayer, however, the qualifying taxpayer may elect under paragraph (g) of this section to treat all interests in rental real estate, including the rental real estate interests held through pass-through entities, as a single rental real estate activity.

(2) Special rule if a qualifying taxpayer holds a fifty-percent or greater interest in a pass-through entity. If a qualifying taxpayer owns, directly or indirectly, a fifty-percent or greater interest in the capital, profits, or losses of a pass-through entity for a taxable year, each interest in rental real estate held by the pass-through entity will be treated as a separate interest in rental real estate of the qualifying taxpayer, regardless of the pass-through entity’s grouping of activities under §1.469–4(d)(5). However, the qualifying taxpayer may elect under paragraph (g) of this section to treat all interests in rental real estate, including the rental real estate interests held through pass-through entities, as a single rental real estate activity.

(3) Special rule for interests held in tiered pass-through entities. If a pass-through entity owns a fifty-percent or greater interest in the capital, profits, or losses of another pass-through entity for a taxable year, each interest in rental real estate held by the lower-tier entity will be treated as a separate interest in rental real estate of the upper-tier entity, regardless of the lower-tier entity’s grouping of activities under §1.469–4(d)(5).

(i) [Reserved]

(j) $25,000 offset for rental real estate activities of qualifying taxpayers—(1) In general. A qualifying taxpayer’s passive losses and credits from rental real estate activities (including prior-year disallowed passive activity losses and credits from rental real estate activities in which the taxpayer materially participates) are allowed to the extent permitted under section 469(i). The amount of losses or credits allowable under section 469(i) is determined after the rules of this section are applied. However, losses allowable by reason of this section are not taken into account in determining adjusted gross income for purposes of section 469(i)(3).

(2) Example. The following example illustrates the application of this paragraph (j).
Example. (i) Taxpayer A owns building X and building Y, both interests in rental real estate. In 1995, A is a qualifying taxpayer within the meaning of paragraph (c) of this section. A does not elect to treat X and Y as one activity under section 469(c)(7)(A) and paragraph (g) of this section. As a result, X and Y are treated as separate activities pursuant to section 469(c)(7)(A)(i). A materially participates in X which has $100,000 of passive losses disallowed from prior years and produces $20,000 of losses in 1995. A does not materially participate in Y which produces $40,000 of income in 1995. A also has $50,000 of income from other nonpassive sources in 1995. A otherwise meets the requirements of section 469(1).

(ii) Because X is not a passive activity in 1995, the $20,000 of losses produced by X in 1995 are nonpassive losses that may be used with passive losses from prior years and disallowed passive losses remaining from prior years and disallowed passive losses from X pursuant to section 469(1). A may offset up to $25,000 of nonpassive income with passive losses remaining from X and passive income from other sources. Therefore, A may offset the $40,000 of passive income from Y with $40,000 of passive losses from X.

(iii) Because A has $60,000 ($100,000–$40,000) of passive losses remaining from X and meets all of the requirements of section 469(1), A may offset part of the $50,000 of nonpassive income. Accordingly, A is left with $30,000 ($50,000–$20,000) of nonpassive income. In addition, A may use the prior year disallowed passive losses of $20,000 of losses in 1995. A does not materially participate in Y which produces $40,000 of income in 1995. A also has $50,000 of income from other nonpassive sources in 1995. A otherwise meets the requirements of section 469(1).

§ 1.469–10 Application of section 469 to publicly traded partnerships.

(a) [Reserved]

(b) Publicly traded partnership—(1) In general. For purposes of section 469(k), a partnership is a publicly traded partnership only if the partnership is a publicly traded partnership as defined in §1.7704–1.

(2) Effective date. This section applies for taxable years of a partnership beginning on or after December 17, 1996.

[T.D. 8799, 63 FR 69553, Dec. 17, 1998]

§ 1.469–11 Effective date and transition rules.

(a) Generally applicable effective dates. Except as otherwise provided in this section—


(2) The rules contained in 26 CFR 1.469–1T, 1.469–2T, 1.469–3T, 1.469–4T, 1.469–5T, 1.469–11T (b) and (c) (as contained in the CFR edition revised as of April 1, 1992) apply for taxable years beginning after December 31, 1989, and ending on or before May 10, 1992.

(3) The rules contained in §1.469–9 apply for taxable years beginning on or after January 1, 1995, and to elections made under §1.469–9(g) with returns filed on or after January 1, 1995;

(4) The rules contained in §1.469–7 apply for taxable years ending after December 31, 1986; and

(5) This section applies for taxable years beginning after December 31, 1986.

(b) Additional effective dates—(1) Application of 1992 amendments for taxable years beginning before October 4, 1994. Except as provided in paragraph (b)(2) of this section, for taxable years that end after May 10, 1992, and begin before October 4, 1994, a taxpayer may determine tax liability in accordance with Project PS–1–89 published at 1992–1 C.B. 1219 (see §601.601(d)(2)(ii)(b) of this chapter).

(2) Additional transition rule for 1992 amendments. If a taxpayer’s first taxable year ending after May 10, 1992, begins on or before that date, the taxpayer may treat the taxable year, for purposes of paragraph (a) of this section, as a taxable year ending on or before May 10, 1992.

(3) Fresh starts under consistency rules—(i) Regrouping when tax liability is first determined under Project PS–1–89. For the first taxable year in which a taxpayer determines its tax liability under Project PS–1–89, the taxpayer may regroup its activities without regard to the manner in which the activities were grouped in the preceding taxable year and must regroup its activities if the grouping in the preceding taxable year is inconsistent with the rules of Project PS–1–89.

(ii) Regrouping when tax liability is first determined under §1.469–4. For the first taxable year in which a taxpayer determines its tax liability under §1.469–4, rather than under the rules of Project PS–1–89, the taxpayer may re-group its activities without regard to