

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Kelly H. Myers, Technical Advisor (Passive Activity Losses & Real Estate)
(Small Business/Self-Employed)

from: Laura C. Fields, Senior Technician Reviewer
(Passthroughs & Special Industries)

subject: Application of the qualifying taxpayer rules of section 469(c)(7)(B).

This Chief Counsel Advice responds to your request for assistance on the application of the qualifying taxpayer rules of section 469(c)(7)(B). This advice may not be used or cited as precedent.

ISSUE

Do the qualification tests in section 469(c)(7)(B) apply separately to each interest in rental real estate of the taxpayer when the taxpayer does not elect to treat all of the taxpayer's interests in rental real estate as a single rental real estate activity under Treas. Reg. § 1.469-9(g)?

CONCLUSION

No, whether a taxpayer is a qualifying taxpayer within the meaning of Treas. Reg. § 1.469-9(b)(6) and section 469(c)(7)(B) depends upon the rules for determining a taxpayer's real property trades or businesses under Treas. Reg. § 1.469-9(d), and is not affected by an election under Treas. Reg. § 1.469-9(g).

FACTS

An individual taxpayer (TP) owns two interests in rental real estate, Property 1 and Property 2, and also owns a real property development trade or business. TP does not make an election under Treas. Reg. § 1.469-9(g). In the year at issue, TP performs more than 750 total hours of personal services on Property 1, Property 2, and the real

property development trade or business, and does not provide personal services in any other trades or businesses.

LAW AND ANALYSIS

Section 469(c)(2) provides that except as provided in section 469(c)(7), the term “passive activity” includes any rental activity. Section 469(c)(7)(A)(i) provides that section 469(c)(2) shall not apply to any rental real estate activity of a taxpayer for a taxable year if the taxpayer meets the qualification test in section 469(c)(7)(B). Section 469(c)(7)(B) provides the following requirements: (i) more than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and (ii) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. An individual taxpayer who owns an interest in rental real estate and also meets these requirements is commonly referred to as a “real estate professional,” although the term used in Treas. Reg. §§ 1.469-9(b)(6) and (c)(1) is “qualifying taxpayer.”

Section 469(c)(7)(C) provides that the term “real property trade or business” means “any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.” Treas. Reg. § 1.469-9(d) provides additional guidance on the determination of a taxpayer’s real property trades or businesses, providing in part,

The determination of a taxpayer's real property trades or businesses for purposes of [meeting the definition of qualifying taxpayer] 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).

Under Treas. Reg. §§ 1.469-9(b)(5) and (c)(3), only time spent in real property trades or businesses in which the taxpayer materially participates under Treas. Reg. § 1.469-5T counts towards meeting the requirements of being a qualifying taxpayer. In the case of individuals, Treas. Reg. § 1.469-5T(a) provides seven tests for material participation. In particular, Treas. Reg. § 1.469-5T(a)(1) provides that an individual will be treated as materially participating in an activity for a taxable year if the individual participates in the activity for more than 500 hours during such year.

Under section 469(c)(7) and Treas. Reg. § 1.469-9(e)(1), if a taxpayer is a qualifying taxpayer for a taxable year, section 469(c)(2) does not apply to any rental real

estate activity of the taxpayer. Instead, a rental real estate activity of a qualifying taxpayer is not a passive activity for the taxable year if the taxpayer materially participates in the activity. In accordance with section 469(c)(7)(A), each interest of the taxpayer in rental real estate is treated as a separate activity for purposes of determining whether the taxpayer materially participates in the rental real estate activity, unless the taxpayer makes an election to treat all interests in rental real estate as a single rental real estate activity under Treas. Reg. § 1.469-9(g).

Therefore, whether a taxpayer is a qualifying taxpayer within the meaning of section 469(c)(7)(B) and Treas. Reg. § 1.469-9(b)(6) depends upon the rules for determining a taxpayer's real property trades or businesses under Treas. Reg. § 1.469-9(d), and is not affected by an election under Treas. Reg. § 1.469-9(g). Instead, the election under Treas. Reg. § 1.469-9(g) is relevant only after the determination of whether the taxpayer is a qualifying taxpayer. However, some court opinions, while reaching the correct result, contain language which may be read to suggest that the election under Treas. Reg. § 1.469-9(g) affects the determination of whether a taxpayer is a qualifying taxpayer. See, for example, Jafarpour v. Comm'r, T.C. Memo. 2012-165, and Hassanipour v. Comm'r, T.C. Memo 2013-88. However, other court opinions recognize that the election under Treas. Reg. § 1.469-9(g) is not relevant to the determination of whether a taxpayer is a qualifying taxpayer. See, for example, Trask v. Comm'r, T.C. Memo 2010-78.

Thus, the first step here is to determine whether TP is a qualifying taxpayer under section 469(c)(7)(B). Pursuant to § 1.469-9(d), TP has reasonably determined under the particular facts and circumstances that TP has a combined real property trade or business for purposes of Treas. Reg. § 1.469-9(d) that includes Property 1, Property 2, and the real property development trade or business. Under Treas. Reg. § 1.469-5T(a)(1), because TP spends more than 500 qualifying hours on this real property trade or business, TP materially participates in this real property trade or business. Therefore, time spent on Property 1, Property 2, and the real property development trade or business may count towards meeting the qualifications of section 469(c)(7)(B). Because TP owns an interest in rental real estate and more than one-half of the personal services performed in trades or businesses by TP during the taxable year are performed in real property trades or businesses in which TP materially participates, and TP performs more than 750 hours of services during the taxable year in real property trades or businesses in which TP materially participates, TP is a qualifying taxpayer within the meaning of Treas. Reg. § 1.469-9(b)(6). Thus, section 469(c)(2) does not apply to any rental real estate activity of TP. Instead, a rental real estate activity of TP is not a passive activity for the taxable year if TP materially participates in the activity.

Next, once it is determined that TP is a qualifying taxpayer, we must determine whether TP materially participates in TP's rental real estate activities to determine whether these are passive activities. In accordance with section 469(c)(7)(A)(ii), because TP has not made an election under Treas. Reg. § 1.469-9(g), Property 1 and Property 2 are treated as separate rental real estate activities. Thus, TP must

demonstrate material participation in Property 1 and Property 2 separately. In other words, TP must separately meet one of the tests in Treas. Reg. § 1.469-5T(a) for each of Property 1 and Property 2. Further, pursuant to Treas. Reg. § 1.469-9(e)(3), TP's participation in the real property development trade or business is disregarded in determining whether TP materially participates in Property 1 and Property 2. If, for example, TP meets one of the tests in § 1.469-5T(a) for Property 1, but not for Property 2, Property 1 will be a nonpassive activity for the taxable year, and Property 2 will be a passive activity for the taxable year.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Please call Benjamin Weaver or Jaclyn Goldberg of the Office of Associate Chief Counsel (Passthroughs & Special Industries) at (202) 317-6850 if you have any further questions.

Sincerely,

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