



Tax Reduction Letter

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Notice 88-94

Transitional Rule Relating to Definition of Activity Under Section 469.

I. Background

Section 1.469-4T of the Temporary Income Tax Regulations will contain rules that treat a taxpayer's operations as one or more separate activities for purposes of section 469 of the Internal Revenue Code of 1986 and the regulations thereunder. The rules in section 1.469-4T will apply to all taxpayers to whom section 469 and the regulations thereunder apply (see section 1.469-1T (b)) for all taxable years of such taxpayers beginning after December 31, 1986. In general, these taxpayers have already filed a return for the first taxable year beginning after December 31, 1986.

II. Transitional rule

Since taxpayers did not have guidance concerning the definition of activity in preparing their 1987 returns, section 1.469-4T of the regulations will provide a transitional rule under which a taxpayer's operations may be treated as one or more activities under any reasonable method. The effective date provisions of section 1.469-4T will provide that this transitional rule applies for activities conducted during taxable years ending on or before the date on which that section is published in the Federal Register.

For purposes of the transitional rule, it generally is reasonable to treat operations that involve the provision of similar goods or services as part of the same activity. Thus, for example, all of a taxpayer's operations that involve farming (within the meaning of section 464 (e) (1) of the Code) may generally be treated as one activity of the taxpayer. Similarly, business operations that are vertically integrated (e.g., manufacturing, wholesaling, and retailing substantially similar property) may generally be treated as part of the same activity although it may also be reasonable to treat such operations as separate activities. In addition, a taxpayer may generally treat business operations as part of the same activity if they are conducted at the same location and are owned by substantially the same persons in substantially the same proportions. Finally, a taxpayer's treatment of rental real estate operations either as a single activity or as multiple activities generally will be considered reasonable.

It is not reasonable to treat rental operations as part of a trade or business activity or to treat nonrental operations as part of a rental activity unless the operations are ancillary to the activity and are insubstantial in comparison to the activity. Thus, real estate development and construction operations may not be treated as part of a rental activity even if the taxpayer rents the property upon the completion of the operations.

These principles also apply to operations that are conducted through a pass-through entity. Thus, an owner of an interest in a passthrough entity may treat operations conducted through the entity as part of one or more activities under any reasonable method.

III. Determination of activities in subsequent taxable years

No inferences should be drawn from the transitional rule described in this notice concerning the general rules of section 1.469-4T. Moreover, all of a taxpayer's activities (including activities that were conducted in taxable years to which the transitional rule applies) must be determined under the general rules for the first taxable year in which the transitional rule does not apply. If a taxpayer's activities determined under the general rules differ from the activities determined under the transitional rule, a second transitional rule will apply for the first taxable year in which the taxpayer's activities are determined under the general rules. This transitional rule will prescribe the manner in which disallowed deductions and credits that are carried to such taxable year under section 469 (b) are allocated among the taxpayer's activities.

IV. Administrative pronouncement

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3 (b) (2) of the regulations and may be relied upon to the same extent as a revenue ruling or a revenue procedure.