

### Reg. Section 1.469-9(e)(4), Example ii

Rules for certain rental real estate activities.

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(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 taxpayer materially participates in the activity. Each interest in rental real estate of a qualifying taxpayer will be treated as a separate rental real estate activity, unless the taxpayer makes an election under paragraph (g) of this section to treat all interests in rental real estate as a single rental real estate activity. Each separate rental real estate activity, or the single combined rental real estate activity if the taxpayer makes an election under paragraph (g), will be an activity of the taxpayer for all purposes of section 469, including the former passive activity rules under section 469(f) and the disposition rules under section 469(g). However, section 469 will continue to be applied separately with respect to each publicly traded partnership, as required under section 469(k), notwithstanding the rules of this section.

(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 allocated to the activity under § 1.469-1(f)(4).

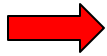
(3) Grouping rental real estate activities with other activities -- (i) In general. For purposes of this section, a qualifying taxpayer may not group a rental real estate activity with any other activity of the taxpayer. For example, if a qualifying taxpayer develops real property, constructs buildings, 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. (i) Taxpayer B owns interests in three rental buildings, U, V and W. In 1995, 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 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.



(ii) Effective beginning in 1996, B makes the election under paragraph (g) to treat the three buildings as a single rental real estate activity. B works full-time managing the three buildings and thus materially participates in the combined activity in 1996 (even if B conducts this management function through a separate entity, including a closely held C corporation). Accordingly, the combined activity is not a passive activity of B in 1996. Moreover, as a result of the election under paragraph (g), disallowed passive losses of \$ 40,000 (\$ 30,000+ \$ 10,000) are allocated to the combined activity. B's net income from the activity for 1996 is \$ 10,000 (\$ 5,000-\$ 5,000+ \$ 10,000). This net income is nonpassive income for purposes of section 469. However, under section 469(f), the net income from a former passive activity may be offset with the disallowed passive losses from the same 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.

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