

2024 National Income Tax Workbook

CHAPTER 9: REAL ESTATE RENTAL
ACTIVITY ISSUES

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Chapter Topics

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Learning Objectives

P. 323

- Calculate income and expenses for a residential real estate rental
- Apply the safe harbors under the tangible property regulations
- Know how to characterize a real estate rental expense as an improvement
- Understand when self-employment tax applies to rental income
- Apply the at-risk rules
- Understand how to apply the passive activity loss rules
- Know how to report rental income and expense

Issue 1: Residential Real Estate Rentals

Rental Income

P. 325

Cross-Reference – Short-term rentals PP. 139-145 2022 *National Income Tax Workbook*

- Rental Income includes
 - rent payments,
 - advance rent,
 - lease cancellation payments,
 - expenses tenant pays for landlord
- May include FMV services rendered by tenant

Rental Income (Continued)

P. 325

Lease with Option to Purchase

Rent payments not exceeding FRV rate treated as rent

If IRS treats as installment sale - option fee = down payment

Lease payments allocated between principal & interest

Treatment based on facts & circumstances – intent of the parties *see Benton v Comr.*

6 factors considering intent of the parties – List p. 325

Tenant Payments-Services Examples PP. 326-327

- Tenant paid landlord's expenses - service provided = rental income
 - Ex. 9.1 Tenant paid repair expenses
 - Ex. 9.2 Tenant paid utilities
 - Ex. 9.3 Tenant provided services (painting) = rental income/expense
 - Ex. 9.4 Tenant made improvements (paint shop built) = improvement-not rent

Practitioner Note-Allocations to personal property - possible depreciation recapture

Recovery Period

P. 328

- MACRS – Recovery class determines recovery period
- GDS – Asset recovery period generally same as property class
- Fig. 9.1 Recovery periods for rental property-GDS
- Depreciation Residential Rental – straight line, mid month convention
 - $\frac{1}{2}$ month depreciation allowed for month property placed in service or disposed of

Recovery Period (continued)

P. 328

Cross-Reference-Short-Term Rentals – Residential rental property is any structure if 80% or more gross rental income is from dwelling units

Does not include a unit in a hotel or motel if more than half of units are used by transients. *See pages 323-324 2023 National Income Tax Workbook*

➤ Calculating Depreciation-see IRS Pub. 946 Appendix A

➤ Ex. 9.7 Calculating GDS Depreciation \$760,000 = building, \$225,000 = land

- Depreciable Basis= \$760,000, Fig. 9.2, year 1 percentage = 3.182
- 2024 Depreciation = (\$760,000 X 3.182%) \$24,183

Rulings & Cases - IRS Issues

471

P.

Reasonable Cause Defense

Johnson v. Commissioner

Facts

John and Judith Johnson filed joint returns. John was in the business of buying, selling, and leasing real estate. They bought a hotel for just over \$4,000,000 and improperly claimed depreciation deductions for 100% of the purchase price. They accomplished this by applying a 7-year depreciation period to the commercial buildings, which should have been subject to a 39-year depreciation period.

Ruling

The taxpayers were liable for the accuracy-related penalty, and reliance on their CPA to prepare the return did not constitute reasonable cause for penalty relief.

Issue 2: Tangible Property Regulations

Safe Harbors

P. 330

- De Minimis Safe Harbor – Per invoice or item expense
 - Allows deductions of \$2,500 without an applicable financial statement
 - Allows deductions of \$5,000 with an AFS
 - Anti-abuse rule- can't split invoices to stay within dollar limits

Practitioner Note: Treas. Regs. Do not reflect increase in original de minimis amounts

De Minimis Safe Harbor (Continued) P. 330

To qualify ordinary & necessary business expenditure must:

1. Be currently deductible-under accounting procedure at beginning of year
 - a. Must be within safe-harbor limits - \$2,500 or \$5,000
 - b. 12-month limit on useful life of item
2. Cannot exceed the safe-harbor limits

De Minimis Safe Harbor

P. 331

De minimis amounts for direct and indirect costs of property produced for resale must be capitalized to the property

Practitioner Note-Purchase Invoice Required

The election is an annual election-all units meeting the requirement must be deducted in the year paid or accrued – consistency matters

➤ Gain on sale of property expensed under de minimis safe harbor is ordinary income

De Minimis Safe Harbor-Cont'd

PP. 331-332

- Practitioner Note-Repairs and Maintenance Costs otherwise deductible –not affected by de minimis safe harbor election
- Taxpayer must have accounting procedures @ beginning of the year
 - Expensing Limit Policy – financial accounting limit also applies to tax
 - Economic Useful Life Policy –
 - Wear & tear
 - Economic changes
 - Climatic
 - Taxpayer's policy on repairs, renewals & replacements

Applicable Financial Statement

P. 332

1. Financial statement filed with SEC
2. Certified audited statement with report of CPA used for credit
3. Financial statement (not tax return) provided federal or state government or agency other than SEC or IRS

Sample Accounting Policy – Figure 9.3, P. 333

De Minimis Safe Harbor Election

P. 333

Election is annual

Cannot be revoked- unless filing deadline not past-then return amended to remove the election

Election statement with return – Entity makes election

Figure 9.4 Election statement

Example 9.8 Apartment Building Improvements

Replaced window for \$2,100 election made, cost expensed

Routine Maintenance Safe Harbor P. 334

- Maintenance on a building or building system **expected** to be performed at least once over a 10-year period
 - Practitioner Note – **Actual** performance not required
 - **Can't be a pre-existing defect fix**
- Planning Pointer-**Have a routine maintenance written plan**

Ex. 9.9 Condo Bldg. Routine Maintenance

Plan to replace \$11,000 handrails in condo units every 4 years qualifies as routine maintenance

Ex. 9.10 Appliance repair cost within 9-year ADS class-life qualified

Safe Harbor for Small Taxpayers

P. 335

- Annual election to expense cost - of building improvements – total cost of repairs - not exceeding **2% of building unadjusted basis or \$10,000** whichever is less if:
 - 3 preceding years - average annual gross receipts < \$10,000,000
 - Buildings unadjusted basis = to or < \$1,000,000
 - Not a change in accounting method
- Practitioner Note – Repairs, maintenance costs under de minimis safe harbor and routine maintenance **are included in total cost of repairs**

Examples Small Taxpayer Safe Harbor

P. 335

➤ Ex. 9.11 More Than One Rental Property

Larry has \$140,000 AGI, owns 2 residential rentals, each has unadjusted basis of \$300,000. \$5,000 repairs/improvements for one property qualifies – \$5,000 cost < 2% of \$300,000 or \$10,000.

2nd property repairs/maintenance of \$7,000 would not qualify. \$7,000 cost > 2% of \$300,000 or 10,000.

➤ Safe harbor applies to each building separately

Examples Small Taxpayer Safe Harbor

P. 335

➤ Ex. 9.12 Improvement to residential rental building

Matteo's 2024 AGI is \$185,000. Owns residential building with unadjusted basis of \$750,000.

He spent \$9,000 for repairs/improvements to the building

Cost qualify because cost $< 2\%$ of \$750,000 or \$10,000

Rental Property Repairs/Improvements

PP. 335-336

- **If** safe harbors not applicable to cost of repairs or improvements:
- Determine whether cost is
 - Betterment
 - Restoration or
 - Adaptation
- 1. Determine whether cost is for building structure or system-8 key systems? -see list page 336
- 2. Cost Betterment, restoration, or adaptation?

Building Expenditures

P. 336

➤ Betterment:

1. Pre-existing (prior to purchase) defect fix
2. Material addition to a unit of property-expansion, capacity increase
3. Material increase in productivity, efficiency, strength, quality or output of the unit of property

Ex. 9.13 Pre-existing Defect-Kathleen's after apartment purchase - cost to make it habitable were capital

Ex. 9.14 Kathleen's replaced wall several years later added 20 sq ft-no rent increase-not a betterment-could be a restoration-

Building Restoration

PP. 336-337

➤ Must be capitalized if cost is:

1. Replacing component sold/abandoned and gain recognized including casualty loss basis adjustment
2. Bringing unit of property in state of disrepair to working order
3. Rebuilding a unit of property to like new at end of class life
4. Replacement of **major component** (*performing critical function*) or **substantial structural part** (*comprise a large portion of unit of property*)

Examples – Restoration

P. 337

➤ Ex. 9.15 Replacing Roof-Single Family Residential Property

- Roof leak-rotten decking - required entire replacement of roof
- Roof performs discreet & critical function of building & is **a large portion of the building replacement is a restoration-must be capitalized**
- Ex. 9.16 Repairing Roof-Apartment **Building-replacement of waterproof rubber membrane over roof decking** is not a significant portion of the roof major component nor is it a structural part of the building. **Not a capital expenditure**

9.17 Cost of duplex to habitable condition=capital cost

Property Adaptation Costs

P. 338

Cost to adapt the property to a new or different use from that originally purchased for

Ex. 9.18 Converting one-unit rental into two units

Costs **are capital expenditures**- involve a *new or different use of the property*

Ex. 9.18 Preparing Property for Sale

Selling property in Ex. 9.18 after painting and repairing floors **not an improvement-can expense as repair cost**

Issue 3: Self-Employment Tax on Rental Income

Introduction

P. 339

In general rent payments for living spaces are not subject to self-employment tax even if it's a trade or business, (except in the case of real estate dealers) and is reported on Schedule E unless:

- Landlord provides substantial services for the convenience of the occupant of the property
- Cross-Reference - Personal & Farm Property
 - See pages 85-93 of *2022 National Income Tax Workbook* for discussion of different rules

Self-Employment Tax

P. 339

- Landlords providing *insubstantial services* (heat, light, cleaning common areas, collecting trash) for convenience of tenant-is **not** self-employment income- report on Sch E.
- Substantial services provided
 - 1. not required to maintain occupancy space,
 - 2. substantial in nature=material portion of rent i.e., maid service, is net earnings from self-employment

Ex.9.20 Substantial Service for Beach House Tenants –maid service, swimming/fishing instruction, mail delivery = self-employment income

Issue 4: At-Risk Rules

At-Risk Limitations

P. 341

- Practitioner Note – Trade or Business, or Investment Activity – **must apply at risk rules before passive activity loss limits**
- Limitations Apply at *individual level for pass-through entities*, and *entity level for closely held c-corporations*
- At risk amount = money + adjusted basis of property contributed to activity + debts taxpayer's personally liable for + FMV *non-entity* pledged property on *entity debt*
- Practitioner Note – At risk amount generally = adjusted basis except when basis increased by nonrecourse debt or obligation to activity co-owner

At-Risk Limitations-Continued

341-342

PP.

- Related party loan to the activity **is not at risk**
 - **Exception** – does **not apply** to an interest as a creditor in activity or
 - An interest as shareholder in c-corp. for corporate debt amounts

Practitioner Note – **Co-Owner Related Party Determination**- IRC Sec.(s) 267(b) @ 10% & 465(b)(3)(C) apply + members of a controlled group

See Van Wyke v Commissioner -50% s/h in S corp. borrowed money from other s/h. Borrowing s/h not at risk for borrowed amounts P. 342

At-Risk Limitations (Cont'd)

P. 342

Ex. 9.21 Ongoing Profits Interest

Apartment owner, Tessa, sold 2 apartments received cash payment of \$1,000,000 and promissory note of \$2,000,000 with each partner's assuming personal liability for note. Partners and Tessa agreed that she would manage apartments for **6% of net profits** from rental activity. **Tessa has a net profits interest in the rental activity** other than as creditor

Amount payable to her **does not increase partners at risk amount** even though they are personally liable on the note. Treas. Reg. Sec. 1.465-8(b)(4)

- See also Ex. 2 of that section - if Tessa is **paid a salary** instead of a net profit's interest amount, it **would increase** partners at risk amount

Protected Amounts 342

P.

- Taxpayer is not considered at risk when protected against loss through:
 - *Non-recourse financing*
 - *Guarantees*
 - *Stop loss agreements*
 - *Other similar arrangements*
- **Not considered at risk – IRC Sec. 465(b)(4); Reg. Sec. 1.465-6**
There is an exception for qualified nonrecourse financing

Qualified Nonrecourse Financing-Real Property PP. 342-343

- IRC Sec. 465(b)(6)(A) and (B) – Taxpayer's at-risk share of qualified nonrecourse financing must be secured by real property used in the activity
- Qualified Nonrecourse Financing = financing
 - Borrowed by taxpayer with respect to the activity of holding real property
 - Borrowed from a qualified person **or** is a loan from the government or municipality **or** is guaranteed by government or municipality
 - **Except** to extent provided in regs. with respect to which no person is personally liable for repayment and
 - is not convertible debt

Qualified Nonrecourse Financing (Cont'd) P. 343

- Limited partner in partnership guaranteeing partnership debt is **not** at risk due to protection against loss unless no remaining rights against partnership or general partner
- LLC all members have limited liability on LLC debt. A.M. 2014-003 (August 27, 2013) IRS chief counsel concluded that “an LLC member is at risk with respect to LLC debt guaranteed by such member without regard to whether the LLC member waives any right to subrogation, reimbursement, or indemnification against the LLC, but only to the extent that, *(continued next slide)*”

Qualified Nonrecourse Financing (Cont'd) P. 343

- (1) guaranteeing member has no right of contribution or reimbursement from persons other than the LLC
- (2) the guaranteeing member is not otherwise protected against loss within the meaning of Sec. 465(b)(4) with respect to the guaranteed amounts and
- (3) the guarantee is bona fide and enforceable by creditors of the LLC under local law

Qualified Nonrecourse Financing (Cont'd) P. 343

- LLC treated as a partnership
 - Member guarantees qualified nonrecourse financing-
 - Guaranteeing member is personally liable for debt-
 - Lender may look to **personal assets** of member guarantor
 - Debt becomes non-qualified - nonrecourse financing **Sec. 1.465-27(b)(2)(i) qualified non-recourse debt must be secured by real property used in the activity of holding real property**
- Non-guaranteeing members of the LLC **cannot** include the debt in their at-risk debt amount

Qualified Nonrecourse Financing (Cont'd) P. 343

➤ LLC treated as a partnership - cont'd

- At-risk amount of LLC member guaranteeing LLC debt is increased only to extent debt:
 - Not previously taken into account by member
 - No right of contribution or reimbursement from persons other than LLC
 - Not **otherwise** protected against loss
 - Guarantee is bona fide and enforceable by creditors of LLC under local law

Qualified Nonrecourse Financing (Cont'd) P. 343

➤ Adjustments to amount at-risk

- Amount at-risk increased for:
 - Additional contributions of cash or property
 - Taxpayer's share of activity income
 - Changing a loan from nonrecourse to recourse
 - Gain recognized on disposition of interest in activity

Qualified Nonrecourse Financing (Cont'd) P. 344

- Practitioner Note – Gain Increases At-Risk Amount but not Basis
 - Miller case-disposition of shareholder stock with no basis and suspended losses with no at-risk amount – gain from disposition increased at-risk amount, but not basis (no suspended loss deduction)
- Activity amount at-risk is reduced by:
 - Losses allowed in previous years
 - Investor's withdrawal of cash or property
 - Investor's share of activity losses
- At-risk decreases below zero require loss recapture IRC Sec. 465(c)(1)

Issue 5: Passive Activity Loss Limits

IRC Sec. 469 Passive Activity Losses

P. 345

- Trade or business in which taxpayer does not participate or:
- Rental Activities – **except**
 - Certain real estate professionals - IRC Sec. 469 (c)
 - Special **\$25,000 loss** allowable for **active participation**
- Passive losses are limited to passive income
- May **fully deduct any previously disallowed passive activity loss in the year you dispose of your entire interest** in the activity
- May **not claim** unused passive activity **credits** merely because you disposed of your entire interest in the activity

IRC Sec. 469 Passive Activity Losses P. 345

Interest, dividends, annuities and royalties **are portfolio income**

Practitioner Note – Other Loss Limitations- First consider basis limits & at-risk limitations.

- PAL rules **apply** to-individuals, estates, trusts, closely held C-corps, and personal service corps
- Does **not apply** to grantor trusts, S-corps, or partnerships **at entity level**
 - Does **apply at flow-through level**

IRC Sec. 469 PALS

PP. 345-346

- **Closely Held C-Corp**, IRC Sec. 542(a) 5 or fewer indiv. directly or indirectly own > 50% of outstanding stock during last half of tax year
- Not Personal Service Corp - can deduct passive losses & credits to extent of *net active income*
 - *Net Active Income = all activity income and deductions-except portfolio income*

Personal Service Corp= principal activity – personal services in health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting > 50% costs from personal service & > 20% costs performed by employee owners who own > 10% of outstanding stock

Rental Activities

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P.

- Tangible Property – real or personal - Used or held for use by customers
- Passive rental loss is deductible to extent of passive income
- **Deduction Exceptions:**
 1. Up to \$25,000 loss for *active participation*-based on MAGI threshold
 2. Real Estate Pro – losses if *material participation* in activity
 3. Current and suspended losses on *qualifying disposition* of activity

Not Rental Activities

P. 346

➤ Activities using tangible property – **not rental activity under** Treas. Reg. Sec 1.469-1T(e)(3)(ii) **if**

1. Avg. days customer use = 7 days or less
2. Avg. period customer use = 30 days or less & owner provides significant per. serv.
3. Owner provides extraordinary personal service making prop. avail. for customers
4. Rental property incidental to nonrental activity
5. Property customarily available during defined business hrs. for nonexclusive use by various customers
6. Property used used in partnership, S corp or joint venture owned by taxpayer

Real Estate Professionals

P. 346

➤ **Real Estate Professionals-activities are non-passive if** materially participate in activity – Taxpayer must meet 2 tests:

1. Must perform $> \frac{1}{2}$ of personal service during tax yr. in real prop. in which t/p materially participates
2. Must perform > 750 hrs. of services during tax yr. in real property trades or business in which they materially participate

Real Property Trade or Business

P. 347

➤ A **real estate interest** includes the trade or business **of income production**- giving rise to IRC Sec. 212 deductions, and is:

- Real property development, construction, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business
- RP operation is day to day operations related to maintenance and occupancy
- Principal purpose-providing use of property to customers
 - *Not including significant personal service*

Real Estate Professional

P. 347

- Real Estate Agent is real **property** broker (brings buyers & sellers together), mortgage broker is **not-**
- Observation- Many of Sec. 469 temp. regs are still in effect
- Both spouses included for measure of material participation
 - Personal Service - Employee/owners of at least 5% stock or equity also count toward material participation
 - IRC Sec. 318 attribution rules apply to determine constructive ownership
- Practitioner Note - Closely held C-corp. (not personal service) – corporation is considered as material participation - >50% gross receipts from real property trade or business qualifies

Material Participation

P. 348

Involvement in real estate activity on **regular, continuous, and substantial basis**

Tests:

1. Participation > 500 hours in tax year
2. Substantial participation (**includes non-owner participation**)
3. >100 hours – not < anyone else (**includes non-owner participation**)
4. Significant Participation Activity – (application to trade or business - **not** rental activity)
5. Material participation for 5 of last 10 years

Material Participation- Tests Cont'd

P. 348

Involvement in real estate activity on regular, continuous, and substantial basis

Tests (cont'd):

6. Material Participation in Personal Service Activity for 3 Years

- not applicable to rental property activity

7. Facts & Circumstances

- Participation not counted in activity if 100 hrs. or less spent during the year managing
- Time not counted if individual other than owner participated to manage or spent more hrs. than owner
- **Proof**-calendar, appointment book, narrative summary showing hrs. spent

Participation

PP. 348-349

- Customary work performed by **owner** of activity= participation
 - Unless principal purpose of work is to avoid PAL rules
- Participation - **Investor in activity**- work performed = direct involvement in day-to-day management (MFJ filers combine spouse participation)
- **Limited Partners** = participation if meeting tests (1), (5), or (6) of material participation tests
- Cross Reference – Aggregation of Activities – see P.P. 340-348 of *2021 National Income Tax Workbook* for discussion

Ex. 9.22 Material Participation-Property Mgr. P. 349

Devon owns condo, not used personally. Rented 350 days by non-related parties, *professional management company manages*. Devon is subject to PAL rules re. loss limitations. Even if he managed the property, PAL rules still apply unless he and spouse together meet material participation or are real estate professionals

Substantiating participation – Reasonable means – identifying service, time spent based on **contemporaneous** appointment books, calendars, or narrative summaries. **See Ex. 9.23 – lack of contemporaneous substantiation**

Special Allowance Rental Real Estate Losses P. 350

- IRC Sec. 469(i) provides that individual, qualifying estate, revocable trust owning **at least 10% value** of all interest in real estate passive activity can deduct up to \$25,000 of related passive loss up to \$150,000 MAGI phaseout if **active participation in activity**
- Active Participation = participation in management decisions or arranging for others to provide services
- Loss Limitation Phase out:
 - MFS – Cannot live together during the year
 - If did not live together – each spouse max. allowance = \$12,500, phased out @ \$50,000 MAGI, fully phased out @ \$75,000

Active Participation

PP. 350-351

Estate's allowance is reduced by surviving spouse allowance

MAGI for this purpose = AGI less net loss from other passive activities allowed for real estate professions, taxable social security, tier 1 railroad retirement benefits. Plus adj. to gross income for retirement account contributions, student loan interest, tuition and fees, exclusion of employer provided adoption assistance, interest on US savings bonds used to pay higher ed. costs, deduction for foreign derived intangible income, and global intangible low-taxed income. See Ex. 9.24 Calculation MAGI and phase out. PP. 350-351

P 350: P Note – Ordering rules net income and losses before \$25k exclus.

P.351: P Note-Passive activity loss excluded for calculation S.E. tax

Passive Activity Credit Limitations

P. 351

- IRC Sec. 469(d)(2) passive activity credit = aggregate tax credits related to passive activities **less** excess aggregate tax liability allocable to passive activities
- IRC Sec. 469(b) allows carryforward of disallowed credits
- **If passive income = or exceeds passive activity credits** – no passive activity credit limit under Sec. 469
 - *Passive activity credits **cannot** offset income tax from active or portfolio income*

Passive Activity Credit Limits-Exceptions P. 351

- Passive activity credit and \$25,000 special allowance rules apply to closely held non-personal service C corps. & qualifying taxpayers can offset credits against tax on up to \$25,000 of non-passive income after accounting for special allowance losses

Ex. 9.25

PP. 351-353

➤ Calculation of Special Allowance for Special Activity Credit

Theo & Tania-file MFJ, 2024 MAGI=\$135,000 (including \$10,000 passive income from rental activity. Theo actively participated. IRC Sec 48 energy credit of \$7,000 from passive activity

Taxable income (with passive income of \$10,000) = \$105,000

Tax with passive income = \$13,382 $(\$105,800 - \$94,300) \times 22\%$

Tax w/o passive income = \$11,182 $[(\$105,800 - \$10,000 - \$94,300)] \times 22\%$

Tax from passive activity = \$ 2,200

2024 disallowed passive activity credit = $(\$7,000 - \$2,200)$ \$4,800

Ex. 9.25 Continued 353

PP. 351-

➤ Calculation of Special Allowance for Special Activity Credit

Special allowance = $(\$150,000 - \$135,000) \times .50 = \$7,500$

Special allowance reduces taxable income to \$98,300 $(\$105,800 - \$7,500)$

Tax after \$7,500 special allowance = \$11,732

Reduction in tax with passive income = \$1,650 $(\$13,382 - \$11,732)$

Carryforward credit to 2025 = \$3,150 $(\$7,000 - (\$2,200 - \$1,650))$

See **Fig. 9.5 Form 8582-CR calculation PP. 352-353**

Practitioner Note- P. 353 Form 8582-CR does not include community revitalization deduction

Special Allowance Credits

P. 353

- IRC Sec 469(i)(3)(B) Special Allowance - regardless of TP participation on Qualified Real Property Rehabilitation Credit under IRC Sec. 47
 - Increases phase out ceiling to \$250,000
 - Excess MAGI reduction begins at \$200,000
 - Tax credit equivalent depends on individual's regular tax rate
- IRC Sec. 469(i)(3)(C) Low Income Housing Credit
 - Eliminates tax credit ceiling & MAGI phaseout regardless of participation
 - No IRC Sec. 469 limitation on individuals using low-income housing tax credits related to passive activities to offset active income

Disposition – Passive Activity

P. 354

- Year of disposition of **entire activity in taxable transaction to non-related party**
- Releases all passive activity suspended losses and
- Current year losses – treated as non-passive
- Gain on disposition will reduce disposition loss year deduction
- Passive activity credits can offset passive income or can elect to increase basis in effected credit property by portion of unused credit
- Practitioner Note – **Expiration Passive Activity Credits** - Presumably when a business credit expires, related passive activity credit also expires

Issue 6: Reporting Real Estate Rental Activities

Ex.—Reporting Real Estate Rental Activities PP. 355-359

Terrance & Mavis purchase **single-family residence** for \$240,000, closing costs = \$850 escrow fee, \$1,300 legal fees, & \$750 title insurance. Basis = \$242,900 in property = \$30,000 land allocation, \$212,900 to building

They borrowed \$192,000 on a 30-year fixed rate loan. Mavis does the accounting for the property. Terrance manages & does minor repairs & maintenance-overseeing major repairs and improvements. Property rented 1/10/2023 \$2,400 per month. Tenant paid \$2,400 deposit, pays all utilities except water. **See Fig. 9.6 P. 355** Listing of income and expenses for year on the property.

Net loss for the year on property was (\$4,120)

Ex.—Reporting Real Estate Rental Activities PP. 355-359

➤ 4 Unit Apartment Bldg. – purchased/placed in service 6/1/2023

- Cost \$400,000 + closing cost of \$2,100 = \$402,100 basis
- Land allocation = \$25,000
- Building basis = \$377,100
- Terrance & Mavis loan to finance purchase = \$375,000
- Building is 40 miles from their residence, Mavis does the accounting. Terrance does minor maintenance & yard work and travels to location. Maintains travel records for travel and work on both properties. Tenants pay all utilities. *See Fig. 9.7* p. 358 for list of income & expenses for year
- Net Loss for year is (\$5,742)

Ex.—Reporting Real Estate Rental Activities PP. 355-359

- Figure 9.8 **See Schedule E P. 357**, line 21 for both properties indicates (\$4,120) loss for single family residential property and (\$5,742) loss for apartment rental property
- Line 22 of Schedule E indicates deductible loss after limitations on Form 8582 in the amount of (\$2,089) for residential property and (\$2,911) for apartment property. **See Fig. 9.9, Form 8582, pages 1 & 2. P.P. 358-359**

General Elections made by McLeod's on Rental Property:

Sec. 1.263(a)-1(f) De Minimis Safe Harbor Election

Sec. 1.263(a)-3(h) Safe Harbor Election for Small Taxpayers

Business Tax Issues

P. 450

Deductions

Mill Road 36 Henry LLC v. Commissioner

Facts

Mill Road 36 Henry, LLC (Mill Road) was an LLC organized by real estate professionals and investors to buy and sell land. Mill Road acquired 117 acres of undeveloped suburban land along a county road for \$1,250,000 million (about \$10,700 per acre) and donated a perpetual conservation easement on 33 acres of the land to a qualified organization. Relying on a professional appraisal, Mill Road claimed an \$8,935,000 charitable contribution deduction (about \$270,800 for each of the 33 acres). The IRS disallowed the charitable contribution deduction.

Ruling

Mill Road made a qualified conservation contribution valued at \$900,000, but because the land had been inventory held for sale to customers in the ordinary course of business, the deduction was limited to Mill Road's \$416,563 adjusted basis.

Questions?
