

**2024  
National Income Tax  
Workbook**

Chapter 9: Real Estate Rental  
Activities Issues  
PP 323-359



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**Chapter Topics** **P. 323**

|   |     |
|---|-----|
| ➤ Issue 1: Residential Real Estate Rentals      | 325 |
| ➤ Issue 2: Tangible Property Regulations        | 330 |
| ➤ Issue 3: Self-Employment Tax on Rental Income | 339 |
| ➤ Issue 4: At-Risk Rules                        | 341 |
| ➤ Issue 5: Passive Activity Loss Limits         | 345 |
| ➤ Issue 6: Reporting Rental Activity            | 355 |

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**Residential Rental Income** 324

Tenant  $\xrightarrow{\cancel{1099}}$  Landlord


*Chapter discusses:*

- Lease with option to purchase
- Tenant provided property or services
- Tenant improvements
- Tangible property regulations - repairs
- Loss? At Risk? Passive? How to Report?

➤ SE Tax?

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Issue #1 – Residential Real Estate Rentals 325

NOT Short Term and Vacation Rentals  
Rentals used personally



**Remember?**  
De Minimis Rule – 14 day test  
Vacation Home limits  
ETC...  
➤ See 2022 book - pages 139-145

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**Rental Income** 325  
Section 61(a)(5)

Will Discuss:

- 1. Lease with option to purchase?
- 2. Expenses paid by tenant
- 3. Improvements paid by tenant

Advanced rent

Lease cancellation payments

Security Deposits?

FMV of property or services

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Lease with Option to Purchase 325



**FOR RENT**

**RENT TO OWN HOME!!**  
**\$690 per month**  
**3 bedrooms & 2 baths**

Is this a disguised sale?

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325

**Lease with Option to Purchase**



If rent payments not over FRV, not treated as an Option to Purchase

**Ordinary Rent**

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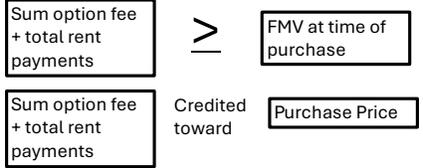
325

**Lease with Option to Purchase**

Factors:

- Terms of lease
- Intent of parties
- Facts and circumstances

*See list on page 325*



Sum option fee + total rent payments  $>$  FMV at time of purchase

Sum option fee + total rent payments Credited toward Purchase Price

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325

**Lease with Option to Purchase**

Under Audit, IRS determines installment sale?

- Initial Option fee is downpayment
- Lease payments allocated between principal and interest according to unstated interest rules



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### Take Away

If the rent is not greater than fair market value, not a disguised sale, even if there is an option to purchase.

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Tenant pays Expenses – Example: 9.1, 9.2 and 9.3 326



Tenant pays for:  
furnace repair  
utilities  
painting services  
Deducts from rent

**Bartering**

Picks up as income  
Deducts expense

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Tenant improvements 326

Tenant Improvements

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Substitute for rent

Intention  
Lease terms  
Circumstances

Leasehold improvements

**Income**

**Not Income**

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**Tenant Improvements – Example 9.4** 326



Builds a small paint shop behind rental



End of lease may be worthless or detrimental

Not included in income

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**Rental Expenses** 327



Tracing interest on refinancing



Allocating purchase price  
Residential rental vs short term rentals

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**Mortgage Interest – Ex 9.5** 327

Refinancing for more than previous outstanding balance  
 Must allocate interest

| 1995 residential rental          | 2024    |   |
|----------------------------------|---------|---|
| Original mortgage - 4.5% balance | 100,000 | <div style="border: 1px solid black; border-radius: 50%; padding: 5px; display: inline-block;">                     ¼ of interest<br/>                     ¾ of interest                 </div> |
| Student loan - 7% balance        | 300,000 |   |
| Refinance                        | 400,000 |   |

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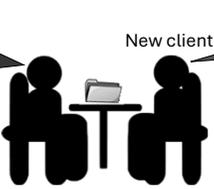
Issue #2 Tangible Property Regulations 330

What is this 18,000 for repairs and maintenance on your rental property?

New client

Just normal maintenance stuff.

What's your next question?



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Issue #2 Tangible Property Regulations 330

Age old Problem:  
Deductible repair? ↔ Capital improvement?  
Increase value. Extend useful life??

Current vs 27.5 years!

Tangible Regs – 3 safe harbors:

1. De minimis safe harbor
2. Routine maintenance safe harbor
3. Small taxpayer safe harbor

If none apply, is the expenditure a:  
Betterment? Restoration? Adaptation?

But, easier or harder??



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#1 De Minimis Safe Harbor 330

Small expenditures for new property or improvements of existing property

Without safe harbor, would have to capitalize

**elect safe harbor:** (Regs still say 500. Raised in 2016)

Write off an item that costs: 2,500 - Without Appl Financial Statements  
5,000 - With Appl Financial Statements

- Anti abuse rules apply
- Landlord can set any dollar amount for expensing, but for tax, limited to 2,500 or 5,000

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**De Minimis Safe Harbor** 331

Other key points:

- ❖ Allowed to deduct as a 162 expense, even if 263 would require capitalization
- ❖ Allowed to deduct when paid or occurred, rather than when first used or consumed
- ❖ However, must capitalize if 263A requires it. I.e: constructing a building.
- ❖ Separate purchase - "invoice" required
- ❖ Annual election – applies to all property that meets definition
- ❖ Any gain on disposition is ordinary income
- ❖ Does not apply to ratable parts, land or inventory

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**De Minimis Safe Harbor** 332

More key points:

- Must have an accounting procedure in place
  - If limit is lower than 2,500 or 5,000, **must follow that limit**
  - If over, still limited to 2,500 or 5,000
  - If accounting procedure has a useful life test (ie: 12 months), still limited to the 2,500 or 5,000

What are "Applicable Financial Statements"?

- SEC
- Certified Audit
- Provided to federal or state government (other than IRS)

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23

**Written Accounting Policy / Election** 333

Page 333 includes:

Sample language for Written Accounting Policy

Sample De Minimis Safe Harbor election:  
Annual Election  
(can file an amended return)

For S corporations and partnerships, the entity must make the election



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Apartment Improvements – Ex 9.8 333

Tracy replaced a window for 2,100



Normally, would have to capitalize and depreciate over 27.5 years

If de minimis safe harbor elected, can fully expense in the current year.

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De minimis safe harbor – take away 333

Can expense separate asset purchases of 2,500 or 5,000

But, need:

- Individual invoices
- Annual election
- Written Accounting policy

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# 2 Routine Maintenance Safe Harbor 334



If expected to be performed more than once over a 10-year period

Don't have to actually perform the maintenance more than once in a 10 year period. Just **expect** to perform



Not to fix a defect that existed when property purchased.



Should have a Written Maintenance Plan (use as evidence)

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Condo – Routine Maintenance – Ex 9.9 334



Ongoing maintenance plan, replace railing for 11,000 every 4 years.

The cost (could be very expensive!) does not affect the application of the safe harbor.

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Routine Maintenance Safe Harbor – take away 334

Prepare a Maintenance Plan that identifies the types of repairs you would expect to have to complete at least once every 10 years.

Then able to deduct the cost of the repair, regardless of cost

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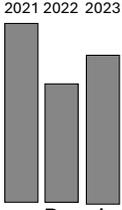
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#3 Safe Harbor for Small Taxpayers 335



2021 2022 2023

Average < 10,000,000

Unadjusted basis (not land) < 1,000,000

+ 

**Can deduct up to the lessor of:**

- 2% of unadjusted basis
- 10,000

Gross Receipts

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**Safe Harbor for Small Taxpayers** 335

**Compare to:**

|                         |  |   |
|-------------------------|--|---|
| Total Repairs<br>XX,XXX |  | Basis under 500,000, then basis x 2%<br>ie: 400,000 x .02 = 8,000                 |
|                         |  | Basis over 500,000, up to 10,000<br>ie: 600,000 x .02 = 12,000, limited to 10,000 |

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**Safe Harbor for Small Taxpayers** 335

*What if you expensed repairs under the de minimis safe harbor or routine maintenance safe harbor already? Can you still claim the small taxpayer safe harbor?*

Yes. But only if the amount expensed under the other two safe harbors are less than the 2%/10,000.

The calculation is made separately for each building.

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**More than one rental property - Ex 9.11** 335

Larry - 140,000 average annual gross receipts

|   |  |  |
|---|--|--|
| 105 Pine Creek<br><br>300,000 unadjusted basis  | .....  | 107 Pine Creek<br><br>300,000 unadjusted basis |
| 5,000 for repairs & improvements<br>< 300,000 x 2% & less than 10,000<br>Can deduct in full | 7,000 for repairs & improvements<br>> 300,000 x 2% = 6,000<br>Cannot use safe harbor |  |

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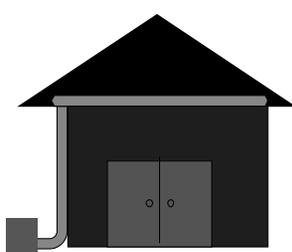
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33

Impr to Residential Rental - Ex 9.12 335



Mattco  
Average  
annual  
Gross  
Receipts  
185,000

750,000 adjusted basis

|               |       |
|---------------|-------|
| Gutters       | 5,000 |
| Other repairs | 4,000 |
| Total         | 9,000 |

Test - Lesser of:  
750,000 x 2% = 15,000  
or 10,000

Mattco can deduct full 9,000

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Safe Harbor for Small Taxpayers – take away 335

This exception does not require an accounting policy or maintenance plan. For properties with adjusted basis under 1,000,000, can automatically deduct repairs up to 2% of unadjusted basis or 10,000.

But, if you go over either of these amounts, cannot use the exception. You can't just go up to the maximum and capitalize the rest.

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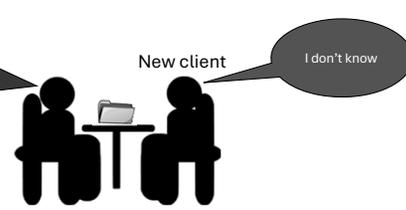
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Issue #2 Tangible Property Regulations 330



We have eliminated 10,000 using the safe harbors. Let's look at the last 8,000 item.

New client

I don't know

Was it a betterment, restoration or adaptation?

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If no safe harbor applies: 335 - 336



1. Determine what “key building system” the expenditure belongs to  
Plumbing, Electrical, HVAC, etc...  
(see full list on page 336)
2. Determine if expenditure is a:  
BETTERMENT  
RESTORATION  
ADAPTATION

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Betterment 336

1. Fix *material* defect that existed before purchase
2. *Material* addition – physical expansion
3. *Material* increase in productivity, efficiency, strength, etc..



**Material?** No definition. Use common sense and judgement

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38

Betterment examples 336

Example 9.13 – Pre-existing defects  
Multi-unit apartment purchased in disrepair. No tenants. Contractor hired to make all necessary repairs. Must capitalize.

Example 9.14 – Replacing a wall  
Same party as 9.13 rents apartments for several years. One wall loses structural integrity. Contractor removes old wall and puts in new wall. Only added 20 feet to the 900 ft apartment.  
No “material” physical enlargement so no “betterment”.

BUT, not done yet. Maybe a RESTORATION?

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39

**RESTORATION** 336 - 337

1. Replacing a component that has been sold or abandoned
2. Bring property back to working order
3. Rebuild a unit to like new condition at the end of its class life
4. Expenditure is for replacement of a major component. Performs a critical function. Critical to the operation of the building.

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**Restoration examples** 337

**Example 9.15**  
Single family residential rental property. Replaced roof decking, insulation, asphalt and various coatings.

- Roof is part of building structure
- Roof performs critical function
- Major component

Must capitalize

**Example 9.16**  
Apartment Building. Rubber membrane on roof leaking. Simply replacing the membrane is a deductible repair

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**Restoration examples** 337

**Example 9.17**  
Two-unit duplex. Water line broke and one unit unoccupied for 2 years. Such disrepair, unable to rent. Important renovations made to make it habitable.

- Considered an improvement because they bring unit back to working order.
- Must capitalize

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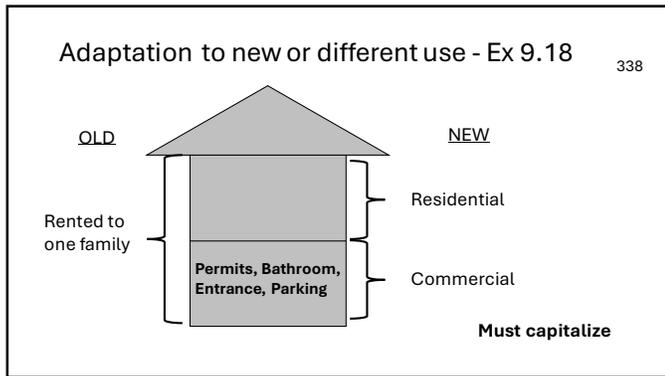
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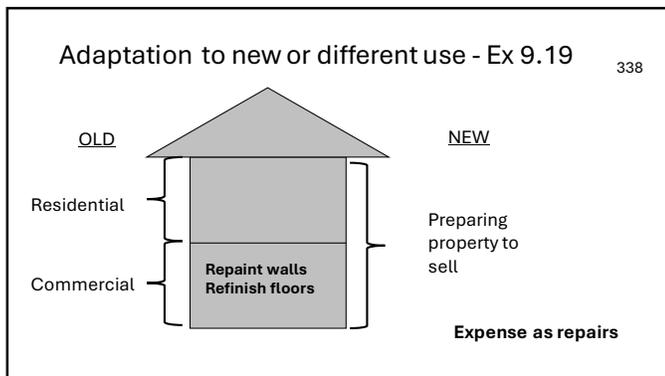
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Issue #2 Tangible Property Regulations 330

Do you have an accounting policy for repairs?  
Does the 18,000 include individual items under 2,500?  
Does the 18,000 include repairs that you will have to do again within 10 years?  
Did you need to fix a defect that was present when you bought the property?  
Did you put on an addition?  
Did you replace a major component, like a roof?  
Did you adapt the property to a different use?

We can expense the whole 18,000

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Tangible Property Regulations – take away 338

Prepare an accounting policy and a maintenance plan.

Try to first meet one of the 3 safe harbors:  
De Minimis  
Routine maintenance  
Small taxpayer

As a last resort, ask enough questions to make sure it's not a betterment, restoration or adaptation.

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Issue #3 – Self-employment Tax 339

|   |  |
|---|--|
| <p>Rental of private homes, duplex, etc</p> <p>So many units that it raises to the level of a "trade or business"</p> <p>Schedule E – no SE tax</p> | <p>Real Estate Dealer</p> <p>Substantial services for the convenience of the occupant performed</p> <p>Schedule C – SE tax</p> |
|---|--|

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Self-employment Tax – Ex 9.20 340

#1



Barbara



#2



Maid services  
swimming / fishing instructions  
Mail delivery  
other

SE TAX

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48

RESEARCH: 340

Better examples of "providing services" to tenants with short term rentals, like AIRBNB:

- Changing linens
- Providing fresh towels
- Cleaning room during stay
- Providing hotel like conveniences, like coffee
- Providing vehicle, bikes or excursion options

le: Looks more like a motel

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Issue #4 – At Risk Rules – IRC 465 341

1. Apply At Risk Rules First

```
graph TD; A[Trade or Business] --- B[Investment]; B --- C[Rental Activities]; subgraph "1. Apply At Risk Rules First"; A; B; C; end; C --> D["2. Then, apply Passive Activity Loss Rules"];
```

2. Then, apply Passive Activity Loss Rules

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Issue #4 – At Risk Rules 341

Applies to:

- Individuals
- Estates
- Trusts
- Certain Closely Held C Corps. 5 or fewer own more than 50% of stock

Does not apply to:

- Partnerships
- S Corporations
- LLCs

Applies at the Individual level

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At Risk – Carrybacks / carryovers 341

|             |                      |   |
|-------------|----------------------|---|
| Prior years | Current year<br>Loss | Subsequent years                              |
|             |                      | Allowable when<br>amount at risk<br>increases |

52

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Amount at Risk 341

|                   |  |   |  |
|-------------------|--|---|--|
| Money contributed | Adjusted basis of property contributed | Debts for which taxpayer is personally liable | Pledged property <b>not used</b> in the activity as security. FMV of the property, less superior liens |
|-------------------|--|---|--|

} AT-RISK

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At Risk equivalent to adjusted basis? 341

**Adjusted Basis?** = **At Risk**

In many cases, yes.

BUT

**Certain nonrecourse debt  
Obligation to a co-owner**

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**Qualified non-recourse financing** 342

- ☀ Secured by the property
- ☀ Activity of holding real estate
- ☀ Borrows from a qualified person (not related) or any federal, state or local government
- ☀ Not convertible debt

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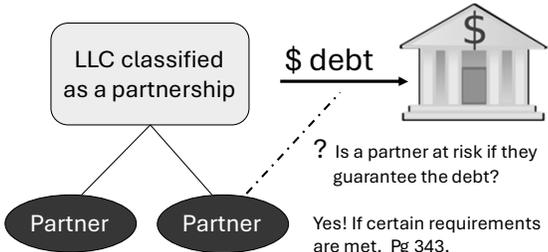
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**LLC Member Guarantees** 343



LLC classified as a partnership

\$ debt

? Is a partner at risk if they guarantee the debt?

Yes! If certain requirements are met. Pg 343.

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**Adjustments to Amount at risk** 343 - 344

Recalculate *At Risk* Annually

|                            | 2023 | 2024  |
|----------------------------|------|---|
| Amount at risk:<br>XXX,XXX |      | Increase:   |
|                            |      | <ul style="list-style-type: none"> <li>• Contributions of cash or property</li> <li>• Share of income from venture</li> <li>• Changing loan from nonrecourse to recourse</li> <li>• Gain recognized on disposition</li> </ul> |
|                            |      | Decreases:  |
|                            |      | <ul style="list-style-type: none"> <li>• Losses allowed</li> <li>• Withdrawal of cash or property</li> <li>• Changing loan from recourse to nonrecourse</li> </ul>  |

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**Issue #5 – Passive Activity Loss Limits** 345

Can we have fun with Passive Losses?

How many of these questions on Passive Losses can you answer correctly?

If you get a high enough percentage correct, you may have a piece of candy!



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61

On Page 344, write down numbers



- 1.
- 2.
- 3.
- 4.
- ...
- 18.

All answers T. or F.

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**Question #1**

A Passive Activity is any trade or business in which the taxpayer does not materially participate; or rental activities for taxpayers, except certain real estate professionals.

True  
False

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**Question #1**

A Passive Activity is any trade or business in which the taxpayer does not materially participate; or rental activities for taxpayers, except certain real estate professionals.

True      Right out of the code! Section 469(c).  
 False      ANY trade or business? Very broad.

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Probably all passive investments!

Don't materially participate!!

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**Question #2**

To determine if a loss is deductible, you apply the loss limitations in the following order:

- Basis
- At Risk
- Passive
- IRC 461 (l) Excess Business Loss

True  
 False

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Question #2

To determine if a loss is deductible, you apply the loss limitations in the following order:

|         |   |                            |
|---------|---|----------------------------|
| Basis   | } | Activity by activity       |
| At Risk |   |                            |
| Passive |   | Net all passive activities |

IRC 461 (I) Excess Business Loss 305,000 / 610,000(J)

True    This is the proper order for determining  
 False    if a loss is deductible.

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Question #3

Passive losses can only be carried over for 7 years.

True  
 False

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Question #3

Passive losses can only be carried over for 7 years.

True  
 False    Passive losses can be carried over indefinitely.

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Question #4

Royalties are portfolio income and not considered passive income.

True  
False

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Question #4

Royalties are portfolio income and not considered passive income.

True  
 False

Royalties are excluded from the PAL calculation, despite their characterization as passive for other Code purposes. Considered portfolio income, like interest and dividends.

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Question #5

The Passive Loss limitations apply to losses claimed by Personal Service Corporations.

True  
False

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Question #5

The Passive Loss limitations apply to losses claimed Personal Service Corporations.

True  
 False

Personal Service Corporations include: Health, Law, Engineering, Accounting, Consulting, Architect. Limitations only apply to the passive activity losses reported on the 1120.

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Question #6

Closely held C Corporations, that are not Personal Service Corporations, can deduct Passive Losses up to the Net Active Income.

True  
 False

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Question #6

Closely held C Corporations, that are not Personal Service Corporations, can deduct Passive Losses up to the Net Active income.

True  
 False

5 or fewer own more than 50%.  
Strange, but true. Net active income includes income and deductions from all activities except portfolio income.

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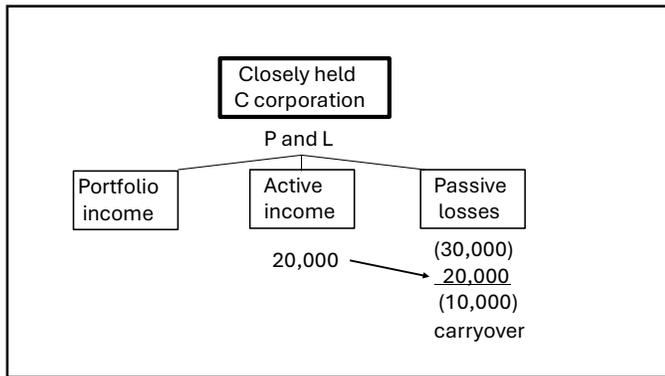
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**Question #7**

When a taxpayer disposes of the passive activity, the taxpayer may deduct carried over passive losses up to the gain reported on a qualified disposition.

True  
False

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**Question #7**

When a taxpayer disposes of the passive activity, the taxpayer may deduct carried over passive losses up to the gain reported on a qualified disposition.

True  
False All carried over losses become deductible in the year of sale.

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**Question #8**

A taxpayer with over 100,000 Modified Adjusted Gross Income can deduct 25,000 in rental real estate losses only if they "Actively Participate".

True  
False

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**Question #8**

A taxpayer with over 100,000 Modified Adjusted Gross Income can deduct 25,000 in rental real estate losses only if they "Actively Participate".

True  
 False

The 25,000 starts to phase out at 100,000.

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**Question #9**

The Passive Loss limitations do not apply to the rental of equipment. Only rental of real property.

True  
False

81

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Question #9

The Passive Loss limitations do not apply to the rental of equipment. Only rental of real property.

True  
 False

With some exceptions, an activity is a rental activity if tangible property (real or personal) is rented. Exceptions:

- Short rental period
- Significant personal services
- Incidental rental activity

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82

Question #10

If a taxpayer has suspended passive losses and sells their entire interest to a related party they cannot deduct the suspended losses until the related party sells the interest.

True  
False

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83

Question #10

If a taxpayer has suspended passive losses and sells their entire interest to a related party they cannot deduct the suspended losses until the related party sells the interest.

True  
False

Normally the entire suspended loss would be deductible, but if sold to a related party, the loss is still suspended. (267 definition)

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84

Question #11

The Passive Loss rules apply at the S corporation and Partnership entity level.

True  
False

85

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Question #11

The Passive Loss rules apply at the S corporation and Partnership entity level.

True  
 False      The rules apply at the owner level.

86

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Question #12

To qualify as a Real Estate Professional a taxpayer must perform more than 1/2 of their time in real property trades or businesses that they materially participate.

True  
False

87

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Question #12

To qualify as a Real Estate Professional a taxpayer must perform more than ½ of their time in real property trades or businesses that they materially participate.

True  
 False

Plus:  
Perform 750 hours in real property trades or businesses in which the taxpayer materially participates.

88

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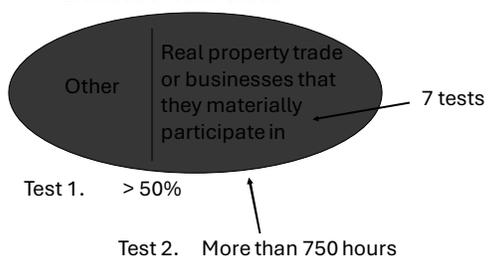
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All trades or businesses



89

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Question #13

The 25,000 special allowance is allowable for any type of passive activity.

True  
False

90

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Question #13

The 25,000 special allowance is allowable for any type of passive activity.

True  
 False

The special 25,000 allowance is only allowable to the aggregate passive losses associated with rental real estate.

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91

Question #14

To qualify for the special 25,000 allowance, a taxpayer must "actively participate". This is a fairly easy test to meet. You only need to make management decisions.

True  
False

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92

Question #14

To qualify for the special 25,000 allowance, a taxpayer must "actively participate". This is a fairly easy test to meet. You only need to make management decisions.

True  
False

Management decisions include approving new tenants, deciding on rental terms, approving capital and repair expenditures and other similar decisions.

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93

Question #15

Based on Modified AGI under 100,000, a taxpayer is eligible for the maximum 25,000 special allowance. If a taxpayer has the following passive income and losses:

Passive losses (30,000)

Passive gains 10,000

The taxpayer can claim the full 25,000 special allowance.

- True
- False

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94

Question #15

Based on Modified AGI under 100,000, a taxpayer is eligible for the maximum 25,000 special allowance. If a taxpayer has the following passive income and losses:

Passive losses (30,000)

Passive gains 10,000

The taxpayer can claim the full 25,000 special allowance.

- True
  - False
- Only 20,000. You must first net all passive gains and losses before applying the special allowance

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95

Question #16

To prove "material participation", a taxpayer must maintain contemporaneous time reports, logs or similar documents.

- True
- False

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96

Question #16

To prove "material participation", a taxpayer must maintain contemporaneous time reports, logs or similar documents.

- True
  - False
- Any reasonable means. I.e: identification of services provided over a period of time and approximate number of hours spent performing such services.

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97

Question #17

A taxpayer who actively participates in rental activities and has a modified AGI of 140,000 cannot claim any of the 25,000 special allowance.

- True
- False

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98

Question #17

A taxpayer who actively participates in rental activities and has a modified AGI of 140,000 cannot claim any of the 25,000 special allowance.

- True
  - False
- Phases out from 100,000 – 150,000  
50 cents on a dollar.  
So  $150,000 - 140,000 = 10,000 \times 50\% = 5,000$  is allowable

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99

Question #18

The Passive Activity limitations do not apply to credits flowing from the activity.

- True
- False

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100

Question #18

The Passive Activity limitations do not apply to credits flowing from the activity.

- True
- False

Credits flowing from a Passive Activity are limited to the regular tax liability allocated to the passive activity, plus an allocation of the special allowance, discussed later.

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101

How many of the 18 questions did you answer correctly?

- 15 – 18 - 3 pieces
- 10 – 14 - 2 pieces
- Participated by answering all questions - 1 piece



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102

### Passive Activity Credit Limitations 351

|                                   |  |
|-----------------------------------|--|
| Non Passive Income <u>XXX,XXX</u> |  |
| Passive Income <u>XX,XXX</u>      |  |
| Total income <u>XXX,XXX</u>       |  |
| Regular Tax <u>XX,XXX</u>         |  |

Tax on  
Nonpassive  
income

Tax on  
passive  
income

CONCEPT

- Losses limited to income
- Passive credits limited to tax on passive income

103

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### Example 9.25 – Passive Credit limit 351

|                          |                 |                 |  |
|--------------------------|-----------------|-----------------|--|
|                          |                 | <u>Return</u>   |  |
| 1040 Theo & Tania:       | 125,000         | 125,000         |  |
| Nonpassive income        |                 |                 |  |
| Passive income           |                 | <u>10,000</u>   |  |
| Modified taxable income: | 125,000         | 135,000         |  |
| Standard deduction       | <u>(29,200)</u> | <u>(29,200)</u> |  |
| Taxable                  | 95,800          | 105,800         |  |
| Tax                      | 11,182          | 13,382          |  |

Tax on 10,000 = 2,200

Rental – actively participate  
 7,000 energy credit  
 4,800 not allowable  
 BUT...

104

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### Passive Credit limit 351

Question:

Remember, some taxpayers can claim up to 25,000 passive losses. Under this concept, can some taxpayers claim a credit in excess of the tax on the passive income?

105

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351

### Passive Credit limit

Question:

Remember, some taxpayers can claim up to 25,000 passive losses. Under this concept, can some taxpayers claim a credit in excess of the tax on the passive income?

## YES

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106

351

### Example 9.25 – Passive Credit limit

|                          |                   |                   |  |
|--------------------------|-------------------|-------------------|--|
| 1040 Theo & Tania:       | Return            | w/ 7,500          |  |
| Nonpassive income        | 125,000           | 125,000           |  |
| Passive income           | <u>10,000</u>     | <u>10,000</u>     | ←  |
| Modified taxable income: | 135,000           | 135,000           |  |
| Standard deduction       | <u>(29,200)</u>   | <u>(29,200)</u>   |  |
| Taxable                  | 105,800           | 105,800           |  |
| Portion of the 25,000    | <u>          </u> | <u>(7,500)</u>    | 3. Rental – actively participate 7,000 energy credit |
|                          | 105,800           | 98,300            |  |
|                          | Tax 13,382        | 11,732            |  |
|                          |                   | 1,650 - 4,800     |  |
|                          |                   | = carryover 3,150 |  |

100,000 – 150,000 phaseout:

|                  |              |
|------------------|--------------|
| 135,000          | 25,000       |
| <u>(100,000)</u> |              |
| 35,000 x .50 =   | 17,500       |
|                  | <u>7,500</u> |

2.

Tax on Passive income: 1.

|                |              |
|----------------|--------------|
| Passive Income | 10,000       |
| Tax rate       | <u>.22</u>   |
| Tax            | 2,200        |
| Credit         | <u>7,000</u> |
| Can we use?    | 4,800.       |

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107

If your taxpayer's modified AGI is under 150,000 and has Passive income, does your tax software calculate this?  
 Plug in:

- All return information
- Modified taxable income
- Passive Activity Gains
- Passive Activity Credits

Does it calculate the amount of passive activity credit can be claimed based on:

1. Amount of tax on passive income
2. Special allowance

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108

355-359

### Issue 6 Reporting R/E Rentals

Terrance & Mavis



1/1/23

|             |                |
|-------------|----------------|
| Land        | 30,000         |
| Building    | <u>212,900</u> |
| basis       | 242,900        |
| Borrowed    | 192,000        |
| Sec deposit | <u>(2,400)</u> |



6/1/23

|             |                               |
|-------------|-------------------------------|
| Land        | 25,000                        |
| Building    | <u>377,100</u>                |
| basis       | 402,100                       |
| Borrowed    | 375,000                       |
| Pet deposit | <u>(1,000)</u> non refundable |

Modified AGI 140,000

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109

355-359

### Reporting R/E Rentals

*Question #1 – Are the security deposit and the pet deposits taxable?*

- Security deposit - no
- Pet deposit - yes. Non-refundable

*Question #2 -Did they properly allocate their purchase price?*

- Yes. 30,000 and 25,000 to land seems reasonable

*Question #3 – Is there an at risk issue?*

- No. They put in cash and borrowed money that they are liable for.

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110

355-359

### Reporting R/E Rentals

*Question #4 – Do they have to capitalize any Repairs/improvements? They made the small taxpayer election.*

Single Family - new garage door  $2,630 + 550 < (212,900 \times 2\% = 4,258)$

Book Wrong! - shingles  $2,404 + 300$  (normal repair)

- can deduct all  $(5,884)$  Total exceeds 2%

Apartment - Windows  $1,700 + 350$

- plumbing fixtures  $500 + 250$  }  $< (377,100 \times 2\% = 7,542)$

- sidewalk/driveway  $1,800$  (normal repair)

- can deduct all  $4,600$

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111

**Reporting R/E Rentals** 355-359

Question #5 - Does the taxpayer have a loss subject to the passive loss rules?  
Yes. See Schedule E - page 358 - line 21

|               |                |
|---------------|----------------|
| Single Family | (4,120)        |
| Apartment     | <u>(5,742)</u> |
|               | (9,863)        |

Question #6 - Can the taxpayer utilize the 25,000 special allowance?  
Yes. calculation            150,000  
Modified AGI            (140,000)  
Balance            10,000 x 50% = 5,000

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112

**Reporting R/E Rentals** 355-359

Question #7 - How do you allocate the 5,000 allowable loss between the 2 properties?  
Proportionately: Part VI form 8582 page 360

|               |                |       |                |
|---------------|----------------|-------|----------------|
| Single family | (4,120)        | .4178 | (2,089)        |
| Apartment     | <u>(5,742)</u> | .5822 | <u>(2,911)</u> |
|               | (9,862)        |       | (5,000)        |

Question #8 - Where do you claim the 5,000 loss?  
Schedule E - Line 22 and ultimately Line 26 page 358

X  
End of  
chapter

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113



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114