


**2024  
National Income Tax  
Workbook**

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



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1

**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
<hr/>	
Lunch	
➤ 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
  
- 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** Section 61(a)(5) 325

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



Rental Payments

Fair rental rate

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

Ordinary Income

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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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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

X

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326

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







**Bartering**

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

Picks up as income  
 Deducts expense

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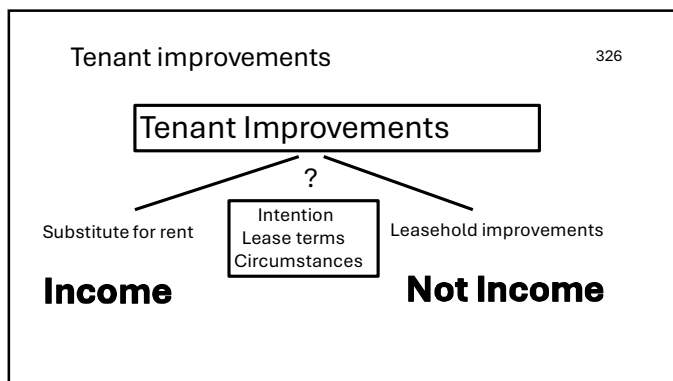
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Tenant Improvements – Example 9.4 326

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	¼ of interest ¾ of interest
Student loan - 7% balance	300,000	
Refinance	400,000	

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**Depreciation** 327

Allocate basis: Land	nondepreciable	
Building	depreciable	27.5 favorable
Personal Property	depreciable	5

(but, recapture)

What if purchase agreement does not allocate purchase price?  
 Use assessed valuations. Allocate proportionately.



See example 9.6

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**Depreciation Method** 328

<i>Residential Rental Property</i>	<i>Nonresidential Rental Property</i>
<input type="checkbox"/> 80% or more of gross rental income is from “dwelling units” <input type="checkbox"/> Not short-term rentals	<input type="checkbox"/> Hotel, Motel, > ½ units used on a transient basis
<p><b>27.5 years</b> s/l mid-month</p>	<p><b>39 years</b></p>

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**Calculating Depreciation – Ex 9.7** 328 - 329



Spring purchases  
for 985,000 on  
2/8/24



Land	225,000
Building	760,000
<b>Total</b>	<b>985,000</b>



GDS 27.5  
recovery period  
Per table A-6:  
2<sup>nd</sup> month of year 1  
= 3.182%

$3.182\% \times 760,000 = 24,183$

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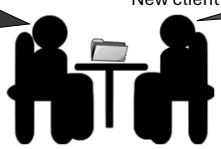
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16

**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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17

**Issue #2 Tangible Property Regulations** 330


Age old Problem:

Deductible repair? ←→ Capital improvement?  
 Increase value. Extend useful life??

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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18

#1 De Minimis Safe Harbor 330

Small expenditures for new property or improvements of existing property

Without safe harbor, would have to capitalize

**If 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. Ie: 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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21

**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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27

**#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

Total Repairs  
XX,XXX

**Compare to:**

- Basis under 500,000, then basis x 2%  
le: 400,000 x .02 = 8,000
- Basis over 500,000, up to 10,000  
le: 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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335

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

Larry - 140,000 average annual gross receipts

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

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335

**Impr to Residential Rental - Ex 9.12**

Mattco Average annual Gross Receipts 185,000		750,000 adjusted basis  Gutters 5,000 Other repairs <u>4,000</u> Total 9,000  Test - Lesser of: 750,000 x 2% = 15,000 or 10,000
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Mattco can deduct full 9,000

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335

**Safe Harbor for Small Taxpayers – take away**

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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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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34

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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35

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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36

**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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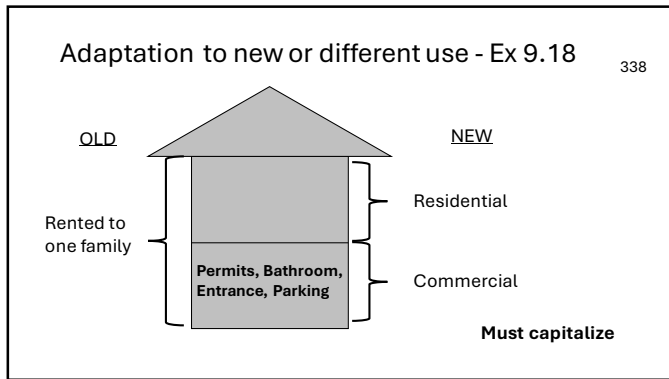
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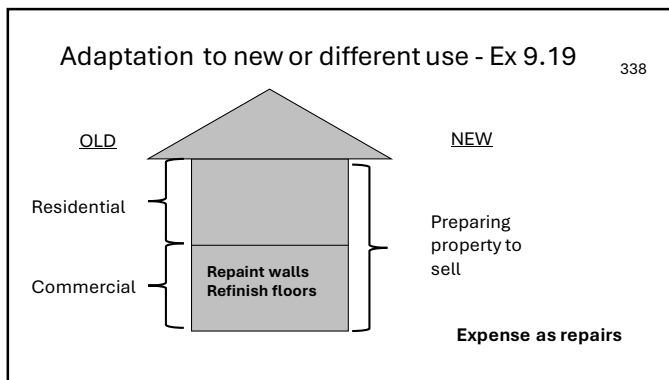
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Issue #2 Tangible Property Regulations 330

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?

Illustration of two people sitting at a table with a laptop.

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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.

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

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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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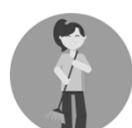
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Self-employment Tax – Ex 9.20 340


#1



Barbara



#2



Maid services  
swimming / fishing instructions  
Mail delivery  
other

SE TAX

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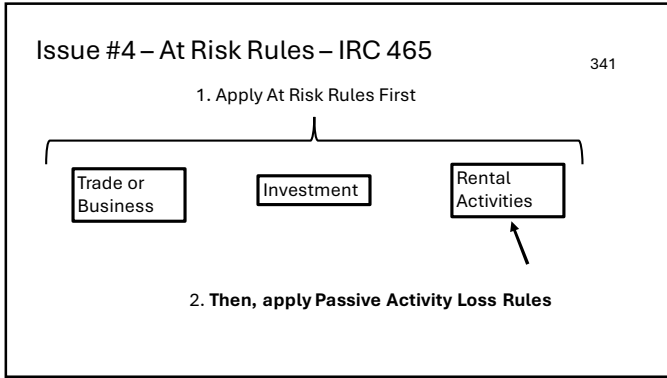
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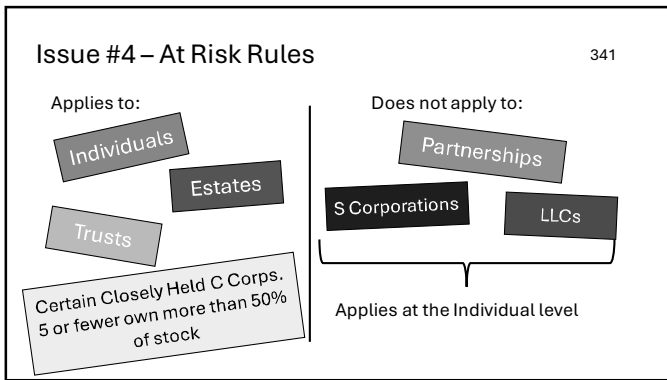
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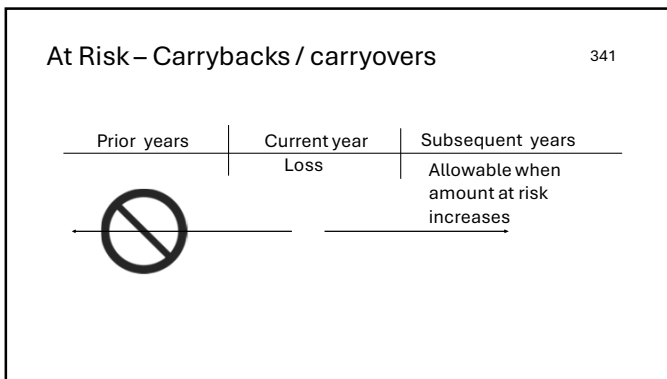
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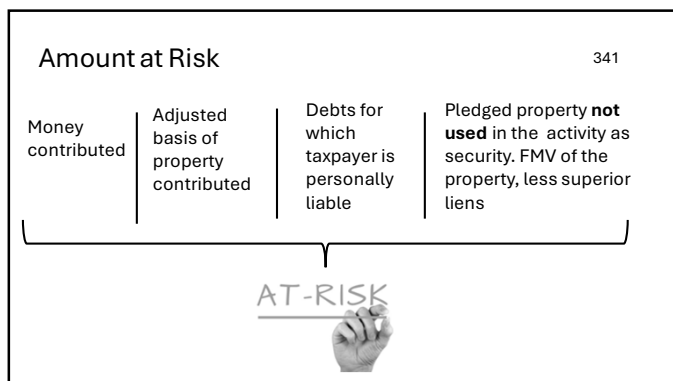
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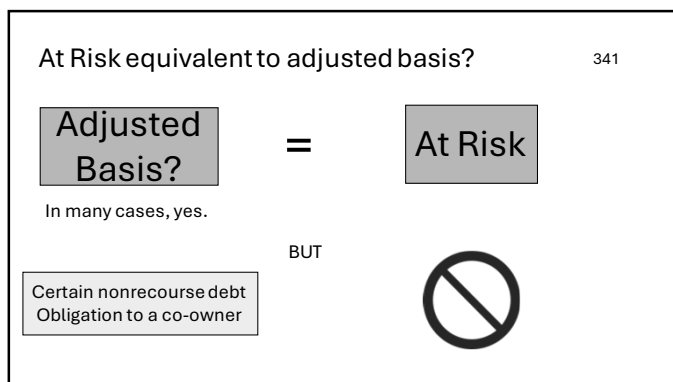
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Form <b>6198</b>		At-Risk Limitations	OMB No. 1545-0712
(Rev. November 2024) Department of the Treasury Internal Revenue Service		Attach to your tax return. Go to <a href="http://www.irs.gov/Form6198">www.irs.gov/Form6198</a> for instructions and the latest information.	Attachment Sequence No. <b>31</b>
Name, address, and return		Identifying number	
Description of activity (see instructions)			
<b>Part I Current Year Profit (Loss) From the Activity, Including Prior Year Nondeductible Amounts.</b>			
See instructions.			
1	Ordinary income (loss) from the activity (see instructions)		1
2	Gain (loss) from the sale or other disposition of assets used in the activity (or of your interest in the activity) that you are reporting on:		
a	Schedule D	2a	
b	Form 4797	2b	
c	Other form or schedule	2c	
3	Other income and gains from the activity, from Schedule K-1 (Form 1065) or Schedule K-1 (Form 1120-S), that were not included on lines 1 through 2c	3	
4	Other deductions and losses from the activity, including investment interest expense allowed from Form 4952, that were not included on lines 1 through 2c	4	
5	Current year profit (loss) from the activity. Combine lines 1 through 4. See the instructions before completing the rest of this form.	5	
<b>Part II Simplified Computation of Amount at Risk.</b> See the instructions before completing this part.			
Adjusted basis is defined in section 1011 in the activity (or in your interest in the activity) on the first day of the tax year. Do not enter less than zero.			
7	Increases for the tax year (see instructions)	7	
8	Add lines 6 and 7	8	
9	Decreases for the tax year (see instructions)	9	
10a	Subtract line 9 from line 8	10a	
b	If line 10a is more than zero, enter that amount here and go to line 20 (or complete Part III). Otherwise, enter 0, and see <b>Part III</b> for information on the recapture rules.	10b	
<b>Part III Detailed Computation of Amount at Risk.</b> If you completed Part III of Form 6198 for the prior year, see the instructions.			

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51

**Profits Interests – Ex 9.21** 342

Tessa owned Sells Northern Realty Partnership

1,000,000 cash  
2,000,000 note (at risk?)

#1 #2 #2

Assumed personal liability for note

Tessa manages apartments ← 6% of profits ← Management fees

Can the 3 partners add the note assumed to their at risk? No! Why?  
Because the note is to Tessa who has an interest in the activity, other than as a creditor.

52

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**Amounts protected from loss** 342

Partners → Partnership

At Risk? Contributions  
Borrowed amounts

Not if: Protected from loss:  
Nonrecourse financing (except qualified nonrecourse)  
Guarantees  
Stop-loss agreements

53

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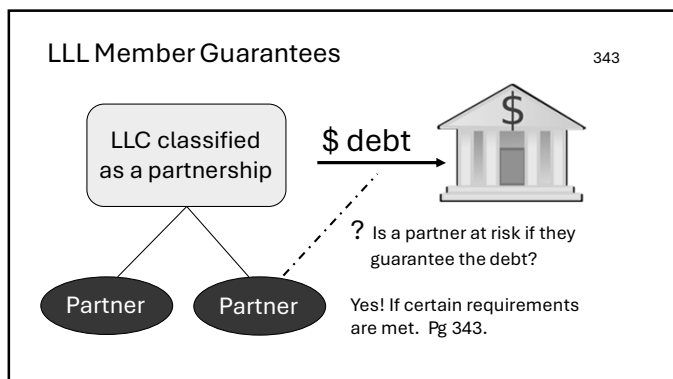
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**Adjustments to Amount at risk** 343 - 344

Recalculate *At Risk* Annually

2023	2024	
		Increase:
		• Contributions of cash or property
		• Share of income from venture
		• Changing loan from nonrecourse to recourse
		• Gain recognized on disposition
		Decreases:
		• Losses allowed
		• Withdrawal of cash or property
		• Changing loan from recourse to nonrecourse

Amount at risk:  
XXX,XXX

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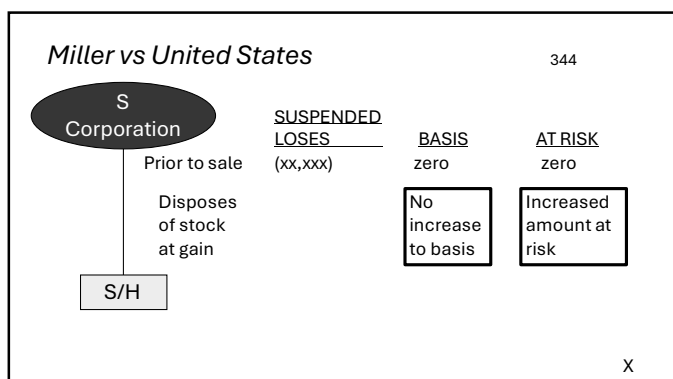
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Issue #5 – Passive Activity Loss Limits 345

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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58

On Page 344, write down numbers



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

All answers T. or F.

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59

Question #1

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 #1

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 (l) Excess Business Loss		

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

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61

Question #2

Passive losses can only be carried over for 7 years.

True  
False

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62

Question #2

Passive losses can only be carried over for 7 years.

True  
 False    Passive losses can be carried over indefinitely.

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Question #3

Royalties that are not derived in the ordinary course of a trade or business are included in PAL calculations.

True  
False

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64

Question #3

Royalties that are not derived in the ordinary course of a trade or business are included in PAL calculations.

True  
 False

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

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65

Question #4

The Passive Loss limitations apply to Personal Service Corporations.

True  
False

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Question #4

The Passive Loss limitations apply to Personal Service Corporations.

- True
- False

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

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Question #5

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 #5

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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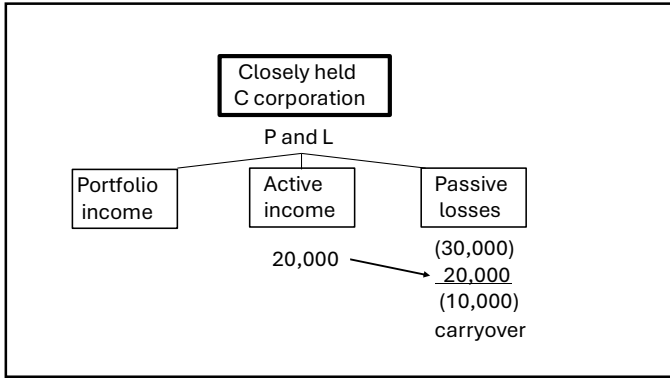
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**Question #6**

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 #6**

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 #7

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

- True
- False

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Question #7

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

- True
- False

Actively Participate. Easier test to meet. Materially participation test is for Real Estate Professionals.

74

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Question #8

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

- True
- False

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Question #8

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. IE:

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

76

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Question #9

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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Question #9

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)

78

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Question #10

The Passive Loss limitations do not apply to rental activities if the average period of customer use is 7 days or less.

- True
- False

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79

Question #10

The Passive Loss limitations do not apply to rental activities if the average period of customer use is 7 days or less.

- True
  - False
- 7 days or less
  - 30 days or less and owner provides significant services
  - Rental of the property is treated as incidental to the nonrental activities

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80

Question #11

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

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81

Question #11

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.

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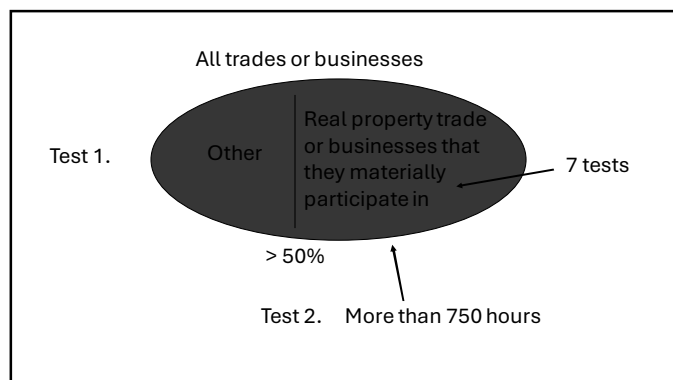
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83

Question #12

To be a Real Estate Professional, a taxpayer must perform more than ½ of their personal services in "real property trades or businesses". Services involving cleaning, maintenance, trash collection, security qualify towards this test.

- True
- False

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84

Question #12

To be a Real Estate Professional, a taxpayer must perform more than ½ of their personal services in “real property trades or businesses”. Services involving cleaning, maintenance, trash collection, security qualify towards this test.

True  
 False

Work not customarily performed by owners does not count toward material participation.

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85

Question #13

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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86

Question #13

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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87

Question #14

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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88

Question #14

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 the losses and gain before applying the special allowance

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89

Question #15

A taxpayer must own at least 10% of all interests in a rental real estate passive activity and actively participate to claim the special 25,000 allowance.

- True
- False

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90

Question #15

A taxpayer must own at least 10% of all interests in a rental real estate passive activity and actively participate to claim the special 25,000 allowance.

- True
- False

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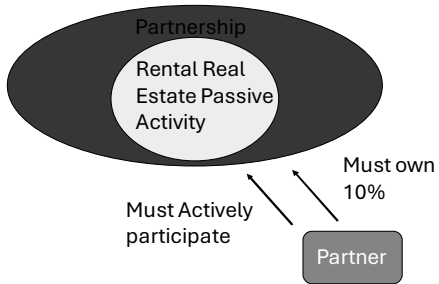
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Question #16

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

- True
- False

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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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94

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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95

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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96



Question #18

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

True  
False

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97

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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98

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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99

### Passive Activity Credit Limitations 351

Non Passive Income <u>XXX,XXX</u>	<div style="text-align: center; border: 1px solid black; padding: 2px; margin-bottom: 5px;"><b>CONCEPT</b></div> <ul style="list-style-type: none"> <li>➤ Losses limited to income</li> <li>➤ Passive credits limited to tax on passive income</li> </ul>
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
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100

### Example 9.25 – Passive Credit limit 351

		<u>Return</u>	
1040 Theo & Tania:	125,000	125,000	 Rental – actively participate 7,000 energy credit
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

4,800 not allowable BUT...

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101

### 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?

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102

**Example 9.25 – Passive Credit limit** 351

	Return	w/ 7,500
1040 Theo & Tania:		
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>(7,500)</u>
	105,800	98,300
Tax	13,382	11,732

100,000–150,000 phaseout:

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

3.  $1,650 - 4,800$   
= carryover 3,150

Tax on Passive Income: 1.

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

Rental – actively participate  
7,000 energy credit

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103

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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104


**Issue 6 Reporting R/E Rentals** 355-359

Terrance & Mavis



1/1/23

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



6/1/23

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

Modified AGI 140,000

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105

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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106

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  $2,630 + 550 < (242,900 \times 2\% = 4,858)$

- shingles 2,404 + 300 (normal repair)
- can deduct all 5,884

Apartment - Windows  $1,700 + 350$  }  $< (402,100 \times 2\% = 8,042)$

- plumbing fixtures  $500 + 250$  }
- sidewalk/driveway 1,800 (normal repair)
- can deduct all 4,600

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107

355-359

### Reporting R/E Rentals

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 (5,742)
- (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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108

<b>Reporting R/E Rentals</b>	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	(5,742) .5822 (2,911)
	(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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