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CHECKPOINT LEARNING

CPE NETWORK TAX REPORT

OCTOBER 2024

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EXECUTIVE SUMMARY

PART 1. CURRENT DEVELOPMENTS

The tax landscape is ever changing with new developments or proposals appearing on a regular basis. Practitioners need to be cognizant of changes to properly advise clients. This material covers some of those changes or notices since the last segment. [Running time: 36:07]

Learning Objective:

Upon completion of this segment, the user should be able to analyze IRS proposals related to basis shifting transactions, assess the appropriateness of the ERC Voluntary Disclosure 2.0, and determine appeal rights after receiving a Letter 105C or 106C from the IRS.

PART 2. INDIVIDUAL TAXATION

In Part 2 of the series, Renee Rodda discusses rental real estate. In this portion, Renee covers the real estate professional exception from the passive activity rules, the Section 199A rental real estate safe harbor, and other miscellaneous issues. [Running time: 31:10]

Learning Objective:

Upon completion of this segment, the user should be able to evaluate the real estate professional exception and identify the requirements of the Section 199A rental real estate safe harbor.

ABOUT THE SPEAKERS

Ian J. Redpath, JD, LLM, is a nationally recognized tax attorney and consultant from Buffalo, New York, and is a principal in the Redpath Law Offices. Mr. Redpath has published numerous articles on contemporary tax issues and co-authored several books on tax topics. He has extensive national and international experience developing, writing, and presenting professional CPE programs. In addition to his active tax practice, he serves as Chairman of the Department of Accounting, Director of Graduate Accounting Programs, and Professor of Taxation and Forensic Accounting at Canisius College in Buffalo.

Renee Rodda, JD, is Senior Vice President of Tax and Accounting for CeriFi, LLC. She is the editor of Spidell's California Taxletter and Spidell's Analysis & Explanation of California Taxes. She has been educating tax professionals for more than 20 years. Renee is also a member of the advisory board for the Franchise Tax Board, the California Department of Tax and Fee Administration, and the Board of Equalization. She is a graduate of Chapman University School of Law with a Tax Law Emphasis.

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EXPERT ANALYSIS AND COMMENTARY

PART 1. CURRENT DEVELOPMENTS

Experts' Forum

Experts' Forum is a popular feature in which we review recent developments in taxation. This month, Ian Redpath looks at Treasury and IRS guidance targeting basis-shifting transactions involving partnerships and related parties, FinCEN rules for the residential real estate and investment advising sectors, and the second employee retention credit voluntary disclosure program.

Let's join Ian.

Mr. Ian Redpath

Hi everybody, welcome to the program. I'm Ian Redpath. This is a segment where we go over some of the things that have happened over the past month since last time we met, from the IRS, from some things from Congress, from the courts, anything that has to do with tax. If it's something new and important, we'll have a chance to look at it.

Let's start right off because the IRS was very active and we received a whole package of guidance targeting basis shifting transactions. Now, these involve partnerships and related parties that take advantage of subchapter K rules, primarily the basis adjustments under §743B and §734B, and those are the ones if you have a §754 election.

Now remember, if you have a §754 election, you must make both adjustments; you have to do the adjustments under §734, even §743. You can't pick and choose. You can't say, "I want to make only one type of adjustment." What the IRS believes is that this has become potentially abusive, especially if you have related parties involved. And so, they've come up with a whole set of guidance, but really, it's warnings as to what they intend to do.

We have really three parts: Notice 2024-54, REG-124593-23, and Rev. Rul. 2024-14. They said we're going to come up with two sets of proposed regulations that are targeting the ability of partnerships and partners to utilize these favorable basis adjustments under §754 adjustments. Again, the §754 is the adjustment election and the actual adjustments are §743 and §734. §743 on transfers and §734 on distributions. We also have a new proposed reg that would make basis shifting transactions and similar transactions to it transactions of interest — so not just §754, but they're widening it to say, "Well if it's similar to it we can challenge that." You're probably familiar with listed transactions and the disclosure requirements. Transactions of interest are transactions that the IRS says "You know what? We don't have quite enough information yet. We're not really quite sure, but we don't think these are good things. So, these are things we want to look at." They're not listed transactions yet, very well may be in the future. By designating these as transactions of interest, the IRS will require certain disclosures from taxpayers, as well as their advisors, if they participate in any defined transactions as we come out with the new regs.

Revenue Ruling 2024-14 provides three factual situations involving basis shifting that the IRS would disregard the basis adjustments under the economic substance doctrine in §7701(o). What they're saying is, "you know, we could still challenge all of these things." Just saying that, they lack economic substance, regardless of the additional rules. So taken together, the guidance makes clear that the IRS is going to closely scrutinize the benefits. Now, not just the benefits of future transactions, but the benefits of past transactions that are described in the guidance. So, the Treasury and IRS are going to issue specific guidance to curtail the ability to do that. Again, being designated as a transaction of interest allows the IRS and Treasury to gather a lot of broad-based information to develop examination techniques to go after other types of transactions. The breadth of the regulatory action that they're talking about, doesn't just take into consideration a highly complex transaction, it's going to take into its sphere really some very common transactions for practitioners and taxpayers. When we're thinking about transactions of interest and tax avoidance schemes, tax avoidance purposes, we're thinking about maybe a large, very complicated transaction. That's not what they're saying here. They're saying they can go after very common transactions if there's a §754 election in effect.

The basis shifting transactions are referred to as covered transactions. And they basically fall into three categories.

High-basis property to a low-basis taxpayer. In this situation, the partnership with related partners distributes high-basis property to a related partner with a low basis in its partnership interest. So, under §734, this will allow the partnership to adjust the basis of its remaining properties equal to the excess of the distributee partners, the value of the property over their basis at the time. With these types of distributions, the Service says, "Well, wait a second, you still may have that property and, whoa, wait, you're getting this basis step-up?" You may say, "Okay, they got a basis step-up." Well, what if the basis step-up is in cost recovery property? What if it's in five-, seven-year property? What if it's subject to bonus depreciation? Those are the types of things that you have to look at. So those distributions could be structured to shift the basis again from non-depreciable or long-life properties onto the retained properties that have favorable cost recovery. Or this could be done in anticipation of a sale. Therefore, we're going to step up the basis and then the partnership sells the asset, paying less tax on the game. In the meantime, under the general rules of §732 of the Code, the general distribution rules, as long as that distributee partner still has whatever property was distributed to them, that high-basis property, then they don't recognize any gain. So, you're getting all the benefits and there's no counter-tax that the IRS would be collecting.

The second are transfers of partnership interests. Again, the §743 adjustment. These involve the transfers of a partnership interest between related parties and the transferor's basis in the partnership interest that exceeds its share of the partnership's basis in the assets. In other words, the outside basis exceeds the inside basis. So effectively, that's a non-recognition treatment for the transferor. These transactions seek to take advantage of the transferee's ability to get a step-up in the basis of the partnership's assets through that §743 adjustment without any tax cost to the transferor.

And then the low-basis property distributed in liquidation. In this particular situation, the transactions involve distributions of low-basis property to a partner, related, in liquidation of their interest. And then the distributee partner has a relatively high basis in the partnership interest. So, the distributee then relies on §732, shifting basis to the assets from its interest to the assets that it receives to get a step up in basis in the property equal to the prior basis in the partnership interest. In this case, the distributed party may be subject to favorable cost recovery or the distributee may be anticipating against selling it, getting a step-up in basis without the corresponding tax consequence on the other side.

The notice sets out two sets of regulations that the IRS intends to propose, and the first would seek to neutralize those benefits by preventing the partners, the partnership and related partners, from using the basis adjustments. In other words, not able to take that additional depreciation, that additional cost recovery. For instance, the basis adjustment allocated under §734 distribution as a result then would be remained in subject to the same cost recovery period and remaining period that was applicable to the property distributed. There's talk that, "Well, you can't take any depreciation until the other party has recognized some income in that related party transaction." So, It's unclear exactly, but that seems to be the intent. I've used the word "related party," so say, "Well, what's a related party?" "Related person" is expanded way beyond what traditionally we think about, §267 and §707(b) when we talk about partnerships. It's extended because these are transactions in interest and it's really going to be extended to what would be tax indifferent. So, related in the traditional sense, or tax indifferent partners like a tax -exempt organization, a foreign partner. A partner who has tax attributes such as losses from other sources that makes them indifferent to the from the covered transaction.

So, think about that. Are we going to have to look and say, "Well wait a second, you had lot of NOLs from another business you had, therefore you're tax indifferent because you're going to be able to offset any gain." Therefore, this transaction now becomes a transaction of interest. This transaction becomes a covered transaction. So, you can see how broad this is going to be, or at least what the IRS says they're intending. Understand the IRS is saying there's a lot of tax avoidance schemes that are going on, very complicated transactions, but it will bring in very common transactions to most practitioners. If you're doing partnership work, you're seeing these types of things on a regular basis and probably you're thinking right now about situations and saying, "Oh my God, it's going cover this, it's going to cover that, we just did this." So, you can see how broad these are.

There's a second set of proposed regs that essentially, if there's a consolidated group and they're partners in a partnership, they'll be treated as a single entity. These covered transactions that are defined in Notice 2024-54, so the proposed regs should follow Notice 2024-54 as to what are covered transactions.

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So, you can see that this is really broad. What is going to be required to be disclosed will be very interesting, but certainly the IRS will most likely require the partnership, the related party, the names, information, the cost recovery deduction on a basis adjustment, the disposition, the asset, the gain or loss on the asset... very broad information that will be needed to report when this comes into effect.

Then, Revenue Ruling 2024-14, the final component is, it provides essentially kind of insight into how the IRS is going to challenge these under the current economic substance doctrine. The IRS said, "We can still go after these regardless of any other rules We can always go after these under the economic substance or the lack of economic substance." This is something that It will have a huge impact on anyone dealing with partnership taxation. I refer you to the guidance which I've which I've mentioned, it's well worth reading if you're doing a lot of partnership work because this can change dramatically our thought process, especially when we're deciding whether to take a §754 election or not.

We've got a case out of the Ninth Circuit, *Hughes*. This is an interesting case because it involves FBARs. And the Ninth Circuit Court of Appeals ruled that the district court applied the correct legal standard when it determined that the owner of two New Zealand businesses owed penalties for failing to disclose their foreign bank accounts, failing to file FBARs. Because willfulness can be established by, and the quote here is, "proof of objective recklessness as well as subjective intent." They kind of followed the concept which was set out in *Safeco Insurance v. Burr*. While it dealt with not a tax issue, it deals with the issue of the standard of proof of willfulness.

Timberley Hughes became the owner of a New Zealand limited company that operated a winery in 2001 and started a second company that runs a wine bar in 2013. The IRS concluded that she failed to file FBARs from 2010 to 2013. It was willful and therefore she would be subject to the higher penalties that are provided under the Code.

She was subjected to \$678, 899 in penalties. This actually did get reduced because the district court found that only willfully filing, didn't apply to all the FBAR reports that she filed, it only applied to two years. They used this reasoning about willful blindness or recklessness. For two of the years, for example 2012, she indicated on her returns, by checking the box, that she needed to file the FBARs, she just didn't file them. And then, in 2013, she answered the same question, but she answered it differently, and of course, incorrectly. So, they said, those two years, that was clearly willful. There was a reckless disregard, willful blindness. But for 2010 and 2011, the service couldn't prove that she was even aware of the requirement and they said her failure was not willful. Now remember, she's going to be penalized for failing to file them, but the willfulness significantly increases the penalty.

She said the failure wasn't willful. She didn't know she had this requirement to file. And the court agreed. She argued that the *Safeco* case, fair credit reporting, doesn't apply to FBARs. The court said it doesn't matter if it's not an FBAR case. It's a determination of what constitutes willfulness and so in that particular context, it does apply. The court said for those two years, she meets the reckless standard and she owes the additional penalties, the higher penalties.

The Inspector General of the Treasury Department, in Audit Report 2024-308-035, released an audit that was initiated. What they said was that based upon the requirements of the Inflation Reduction Act of 2022, that the IRS and Chief Counsel are required to communicate and provide guidance to taxpayers and tax professionals regarding tax law changes.

The Treasury Inspector General said this is just not happening in certain areas. In certain areas, they said they are just not providing the level of guidance that they should. The Treasury Inspector General calls it "pre-rulemaking" by issuing notices and other guidance that can be followed. Specifically, they talked about §45X, and they found that most of the comments that were brought weren't addressed. That the IRS was not addressing the comments to provide appropriate guidance to taxpayers.

The Treasury Inspector General says the IRS needs to get their act together, needs to start providing us with better guidance when there are new laws. So really, the IRS has, again, they're not providing us the guidance that we're entitled to.

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The Financial Crimes Enforcement Network issued two new sets of rules aimed at preventing the misuse of the U.S. financial system (FinCEN RIN 1506-AB54, FinCEN RIN 1506-AB58). These are really hit at residential real estate and the second set at the investment and advising sectors. The first set of rules, basically what they, FinCEN, were trying to say is that when there are cash sales, that would indicate that there is some potential that in fact there could be some level of money laundering going on, for example.

The residential real estate rule will take effect December 1, 2025. And that requires reports and records on certain non-financed (cash) real estate transactions to legal entities and trusts. It doesn't apply to transfers to individuals. It does not apply to transfers to individuals.

The goal is to increase the transparency. Again, there's a real estate report and that has to be submitted for what they call high risk transactions. In completing the report, the reporting person can rely on the information provided by others, as long as that information is certified in writing. You can't just rely on it. It has to be certified in writing.

Overall, it kind of balances the usefulness of the information with minimizing the burdens on individuals who have to report. The basics of the rule require that certain persons involved in real estate closings and settlements have to submit to FinCEN and keep the records on non-finance transaction of residential real property to certain specific legal entities and trusts. Again, if it's made directly to an individual, this would not apply. Well, they have the name of the person, so they're not looking at going through a sham type of transaction.

Under the rule, one real estate professional involved in the transaction, for example, a shell company or a trust will have to report to FinCEN. Must name the beneficial owner behind that shell company or the beneficial owners of the trust who are buying that property. The closing agent, an independent third party who facilitates the closings is the primary person who is required to report. However, what if you don't have that? Then the rule provides a cascading list of the professionals involved in the transfer of title that have a duty to report. But only one person has to report; there only has to be one report that is made.

Again, you can see what they're looking at: shell companies and certain trusts, especially a foreign trust. They're looking at things and saying, "We want to know who the beneficial owners are. We want to know that we want to know what was purchased, what the price was. Who are the beneficial owners?"

It doesn't require reports for a lot of common, what they call "low risk," title transfers such as a transfer at death, a divorce, a bankruptcy, a transfer to a trust. So those of you in estate planning, don't get worried. I know you may get worried and say, "Wait a second, a trust, I got to do this?" It's not going to apply if the transfer was to a trust as part of estate planning.

Again, you're allowed to reasonably rely on the information that's provided. As long as you don't know otherwise that it's false, you're allowed to rely on it. There's a whole series of transactions that there's no report. So, for example, a grant of an easement or a transfer, a transfer resulting from death, or incident to a divorce or bankruptcy, any transfer supervised by a court in the United States. The report doesn't have to be filed if it's an exempt legal entity or trust, because they're considered highly regulated.

Remember, this is going to come in 2025. This starts December of 2025. So, when is that report due? That report has to be filed by the final day of the following month after the closing, or 30 days after the date of the closing, whichever is later.

The second set of regs, the final investment advisor rule, these will take effect January 1 of 2026. That requires investment advisors to have programs to prevent money laundering, terrorism, financing, report suspicious activities, a lot of different reporting requirements. Essentially what this new rule is doing is adding certain people, registered investment advisors and exempt reporting advisors (RIAs and ERAs), to the definition of a financial institution in implementing the bank secrecy. Essentially now, they're considered financial institutions for the same reporting requirements under the bank secrecy rules. That's a major impact if you have a client in that area.

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Just a side note, IR-2024-219, the maximum educator deduction, the IRS says we're going to still keep it at \$300. Now it's been at \$300 since 2022, and it was \$250 before that. And again, if you're married filing jointly and you're both educators, you can file it. To be eligible, the educator, expense deduction, teacher, instructor, counselors, principals, aides even, who work at least 900 hours a school year in a public or private school, elementary or secondary.

It's broad what it covers: books, supplies, equipment. It also includes COVID things. But things that aren't covered would be, for example, costs for homeschooling, non-athletic supplies for courses in health. Those are not included. It can also be used to offset expenses for professional development courses relevant to the teaching.

It's back, or I guess if those who remember Poltergeist, it's baaaack. We have now the second voluntary disclosure program under the Employee Retention Credit. I know you're saying, "I'm employee-retention-credited out." I'm so glad I'm not hearing every single day, all day long ads for this. The ERC 2.0, it is not as beneficial as the former program was. It reflects kind of a shift in incentives. The current program offers a 5% less discount compared to the previous one.

The IRS gave you plenty of chance. Still look at it, it's still an advantage. The government is telling people, act very swiftly. The government intends, and the IRS plans to send up to 30,000 letters to reverse or recapture the more than \$1 billion in what they claim are improper claims. It's going to go up, even go up because they believe that there were thousands more that have been filed since last fall, or rather, that are going to be filed this fall, I should say. You have these letters that are going to come out. Basically, the IRS is going to try to get back what they believe was improperly obtained credits. So, watch out for that. In the National Taxpayer Advocate blog, people are getting these rejections. They receive Letter 105, Claim Disallowed, or Letter 105C, Claim Partially Disallowed, after the IRS rejects a claim.

Now, they may believe that they had a legitimate claim. The IRS is using a risk scoring analysis instead of the first auditing claim, so they're looking at the claims using a risk scoring analysis. What to do? Well, a lot of the letters that are going out don't really provide language that you're entitled to an appeal right and the Taxpayer Advocate reminds you that you have the right to appeal regardless of whether the IRS includes that information in the notice. However, the appeal here is a protest, but rather than going to appeals because it hasn't gone through an audit by the IRS, appeals doesn't do its own audits. It looks at the information from the audit. So, the Taxpayer Advocate warns taxpayers and practitioners that it could take months for the IRS to conduct its post-protest, where you've protested, it's sent for audit. Then after that, it'll be forwarded to appeals. Once it gets to appeals, it could take five months or longer for appeals to hold the initial conference. Potentially, you could speed it up by appeals fast track, but they're so far behind on that, that's not going to speed it up that much. Taxpayers who don't want to protest their claim of disallowance to the appeals can file a lawsuit in the district court or the claims court, not in the Tax Court, within two years of receiving the disallowance. They don't need to have an appeals review first. Note that that two-year filing period begins to run from the date of the notice that was received.

In IR 2024 -216, working parents who send their kids to summer camp, they said that may qualify for the Child and Dependent Care Credit. If you're working, both spouses are working or seeking work or one is a full-time student or disabled, these expenditures for a day camp could qualify. However, an overnight camp will not.

Well, I want to thank you for joining me again. Boy, there's a lot of stuff going on with the service and especially those rules with §754. We're really going to have to pay very close attention to those because they could impact anyone who does any partnership tax work.

So again, I want to thank you very much for joining me. I'll see you next month. And as always, please be safe.

SUPPLEMENTAL MATERIALS

Experts' Forum

By Ian J. Redpath, JD, LLM

A. Notice 2024-54, Proposed Regulations (REG-124593-23) and Rev. Rul. 2024-14

The Service has issued guidance targeting basis shifting transactions involving partnerships and related parties. These are focused on transactions that take advantage of the formal Subchapter K rules related to both distributions of partnership property and transfers of partnership interests (generally the §754 adjustments under §§734(b) and 743(b)). It should be remembered that the election is irrevocable without IRS permission which they do not readily grant.

Notice 2024-54 simply sets forth that the Service will be issuing proposed regulations targeting the ability of partnerships and partners to utilize favorable basis adjustments in certain basis-shifting transactions.

The proposed regulations (REG-124593-23) issued by the Service would designate certain basis shifting transactions, or any transaction that is substantially similar, as "transactions of interest." This will require additional disclosures from taxpayers as well as any advisors participating in such transactions.

The third guidance is Rev. Rul. 2024-14 which provides examples of three situations involving partnership basis shifting transactions that the Service would not allow the favorable basis adjustments under the economic substance doctrine described in §7701(o).

The proposed actions are extremely broad. They will not only encompass the highly complex situation but could cover very common transactions that affect many taxpayers and practitioners.

Essentially, there are three types of situations that the Service is looking at as "covered transactions:"

- 1) Transactions in which a partnership with related partners distributes high-basis property to a related partner with a low-tax basis in its partnership interest. This generally allows the partnership to obtain a favorable upward basis adjustment equal to its remaining property under §734(b). The distributee partner will allocate all or a portion of the interest basis to the property under §732 and not recognize income until the property is disposed of. The partnership's upward adjustment is equal to the excess of the FMV of the property on distribution and the basis allocated to it. This could be structured to shift basis away from nondepreciable property or property with longer class lives onto retained properties with more favorable cost recovery rules. It could also be used to increase the basis of property prior to a property sale.
- 2) The second type of transactions involve transfers of partnership interests between related parties where the transferor's basis in its partnership interest exceeds its share of the partnership's bases in its assets (inside basis) in a non-recognition transaction to the transferor. Thus, attempting to take advantage of the transferee's ability to receive a step-up in the basis of the partnership's assets under a §743(b) adjustment with no tax cost to the transferor.
- 3) The third type are transactions that involve distributions of low basis property to a partner in liquidation of its partnership interest where the distributee partner has a high basis in its partnership interest. Under §732 the transferee obtains a stepped-up basis in the distributed property equal to its prior interest basis. Usually, the distributed property is subject to a favorable cost recovery method, or the distributee plans on selling the distributed property.

In Notice 2024-54, the Service outlines two sets of regulations it plans to propose. The first would seek to neutralize the benefits sought from covered transactions by preventing partnerships and related partners from utilizing the basis adjustments generated through such transactions. The proposed regulations would employ conceptually similar limitations on basis adjustments generated through other types of covered transactions.

These proposed regulations will utilize a concept of "related persons" that is broader than under §§267(b) and 707(b). Examples of tax-indifferent partners who could be treated the same as related parties could include tax-exempt partners, foreign partners, or partners with tax attributes such as losses from other sources.

The second set of forthcoming proposed regulations announced by the notice would be issued under §1502 and provide single-entity treatment for members of a consolidated group of corporations that are partners in a partnership. The idea is to prevent covered transactions from shifting basis between group members.

The second part of the guidance package is a set of proposed regulations (REG-124593-23) that would designate various partnership basis-shifting transactions as transactions of interest under §6011. The designated transactions generally are the same as covered transactions set out in Notice 2024-54. They would require taxpayers and material advisors participating in partnership basis-shifting transactions to file certain disclosures for reportable transactions. Transactions of interest are reportable transactions that must be disclosed on Form 8886. The IRS believes many of these transactions already lack economic substance and taxpayers could be penalized for a lack of disclosure on Form 8275.

The last part of the guidance package is Rev. Rul. 2024-14. It provides some insight into how the IRS may challenge partnership basis-shifting transactions now under the current economic substance doctrine and sets forth three scenarios.

B. Hughes, CA9, 134 AFTR 2d 2024-5107

The 9th U.S. Circuit Court of Appeals ruled that a district court applied the correct legal standard in determining that an owner of two New Zealand businesses owed penalties for failing to disclose foreign bank account records (FBAR) because willfulness can be established by "proof of objective recklessness as well as subjective intent. It adhered to the Supreme Court's standard for assessing civil FBAR penalties provided in *Safeco Insurance Co. of America v. Burr* (No. 06-84).

In 2001, Hughes became the owner of a New Zealand limited company that operates a winery. In 2013, Hughes started a second company that runs a wine bar. The IRS concluded Hughes' failure to file FBAR reports as required by the Bank Secrecy Act of 1970 for tax years 2010-2013 was "willful" and, therefore, subject to enhanced penalties under §5321 for violating §5214. In total, Hughes was assessed \$678,899 but did not pay, prompting the government to sue in federal court. However, the district court determined that Hughes willfully failed to file FBAR reports only for the years 2012 and 2013 and reduced the penalty assessment to \$238,125.19. Using the Supreme Court's reasoning in *Safeco*, the district court concluded that willfulness can be shown through recklessness or "willful blindness."

In 2012, Hughes indicated on her return that she knew she was required to file an FBAR by checking the corresponding box but did not do so. The next year on her 2013 return she answered the same question incorrectly. The district court said Hughes should have known, or was in position to know, of her reporting obligations.

For tax years 2010-2011, it could not be proven that she was aware of the requirement or accessed information that would have told her. She was not liable for the enhanced penalties.

C. TIGTA Audit Report No. 2024-308-035

The Treasury Inspector General for Tax Administration (TIGTA) has released an audit which was initiated to evaluate the IRS and the Office of Chief Counsel's efforts to implement the Advanced Manufacturing Production Credit and related provisions. According to provisions in the Inflation Reduction Act (IRA) of 2022, the IRS and Chief Counsel are "required to communicate and provide guidance to taxpayers and tax professionals regarding tax law changes," the audit noted. The Chief Counsel and the Treasury Department issued two notices, Notice 2022-47 and Notice 2022-50, which did not include any initial taxpayer guidance and were issued to aid the originators in drafting energy credit guidance, the audit said. The notices requested general comments in addition to specific comments on questions appearing in the notices. TIGTA refers to this process as 'pre-rulemaking' because it proceeds any guidance. This is not in compliance with the requirements of the IRA 2022. It noted a lack of written procedures and documentational evidence for the review and consideration of comments submitted during pre-rulemaking.

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Supplemental Materials CPE Network® Tax Report

D. FinCEN: Anti-Money Laundering Regulations for Residential Real Estate Transfers (8/29/2024) and Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers (09/04/2024)

The Treasury's Financial Crimes Enforcement Network (FinCEN) issued two rules to help safeguard the residential real estate and investment adviser sectors from illicit finance. The final residential real estate rule requires certain industry professionals to report information to FinCEN about non-financed transfers of residential real estate to a legal entity or trust, not an individual, which presents a high illicit finance risk. The rule increases transparency and limits the ability of illicit actors to anonymously launder illicit proceeds through the American housing market. The final investment adviser rule will apply anti-money laundering/countering the financing of terrorism (AML/CFT) requirements—including compliance programs and suspicious activity reporting (SAR) obligations—to certain investment advisers that are registered with the U.S. Securities and Exchange Commission (SEC), as well as those that report to the SEC as exempt reporting advisers. This is meant to address the uneven application of AML/CFT requirements across the industry.

The final residential real estate rule is effective December 1, 2025. It requires reports and records on certain non-financed real estate transfers to legal entities and trusts. A "Real Estate Report" must be submitted for high-risk transactions, including details on the reporting person, property owner, beneficial owners, and transaction details. The reporting person can rely on information provided by others, as long as it is certified in writing. Under the final rule, one of the real estate professionals involved in an all-cash home sale to a shell company or trust will have to file a report with FinCEN naming the beneficial owner behind the legal entity buying the property. The closing agent, an independent third party who facilitates many closings, is the primary person tasked with drafting the required report. If there is no closing agent, the reporting duty falls to a "cascading" list of professionals involved in the title transfer process, but only one report needs to be filed for each transaction. FinCEN does not require the reports for certain common, transfers, such as those that stem from death, divorce, bankruptcy, or transfer into a trust for estate planning. Note that there is no requirement for financed transactions. In addition, certain transactions are listed in the rule as exempt from reporting. The reporting person must file the report by the final day of the following month after which a closing took place, or 30 days after the date of the closing, whichever is later.

The final investment adviser rule takes effect on January 1, 2026. It requires investment advisers to have programs to prevent money laundering and terrorism financing, report suspicious activities, and follow certain reporting and record-keeping rules. The rule applies to certain investment advisers, including those registered with the SEC and those with offices outside the U.S. that operate in the U.S. or serve U.S. clients. It does not apply to state-registered advisers, foreign private advisers, or family offices. However, it adds certain registered investment advisers (RIAs) and exempt reporting advisers (ERAs) to the definition of "financial institution" under the regulations that implement the Bank Secrecy Act (BSA) and requires RIAs and ERAs to report suspicious activity to FinCEN, among other changes.

E. IR 2024-219

The maximum educator deduction for unreimbursed 2024 out-of-pocket classroom expenses is still \$300. If both spouses qualify it is a maximum of \$600 on a joint return. The limit is unchanged since 2022. This deduction is for AGI and offsets expenses for classroom supplies and materials, which many teachers spend their own money on.

To be eligible educators include teachers, instructors, counselors, principals, and aides who work at least 900 hours a school year in a public or private school—elementary or secondary.

It includes out-of-pocket expenses on classroom items like books, supplies, and equipment (including computers and software), professional development courses, as well as COVID-19 safety measures such as masks, disinfectants, and air purifiers. However, costs for homeschooling or nonathletic supplies for courses in health or physical education are not included.

F. IR-2024-213, ERC Voluntary Disclosure Program 2.0

The second ERC-VDP is open through Nov. 22, 2024, for 2021 tax periods. The ERC-VDP for 2020 tax periods is no longer available. The second ERC-VDP program requires you to:

- Complete and send an application package for the second ERC Voluntary Disclosure Program,
- Voluntarily pay back the ERC, minus 15%
- Cooperate with any requests from the IRS for more information, and
- Sign a closing agreement.

The eligibility criteria remains consistent with the first program, focusing primarily on employers who have faced significant declines in gross receipts or operational impacts due to government orders during the pandemic. The government encourages businesses to act swiftly, as engaging with the program allows participants to potentially circumvent the more stressful recapture process that could follow if they do not disclose their circumstances correctly.

The IRS will be issuing recapture letters. It plans to send up to 30,000 to reverse or recapture potentially more than \$1 billion in improper ERC claims. These letters outline amounts owed by employers, resulting in immediate tax liabilities. Employers must respond quickly to avoid the collections process.

G. National Taxpayer Advocate (NTA) Blog 8/21/2024

The NTA's post was prompted by the notice of disallowance letters concerning the Employee Retention Credit that the IRS recently sent. Businesses received either letter 105C, Claim Disallowed, or 106C, Claim Partially Disallowed. The IRS rejected their claims using a risk-scoring analysis rather than conducting an audit of the claims. The IRS has admitted that some of the disallowance letters failed to inform taxpayers of either their appeal rights or why their claim was disallowed.

The NTA clarifies that taxpayers have a right to an appeal even if it is not in the disallowance notice. Under normal IRS procedure such appeals, also known as a protest, go directly to the Independent Office of Appeals. However, under the disallowed ERC appeals procedure used by the Service, the protest will first be sent to an IRS revenue agent who will either: allow the claim, request additional documentation from the taxpayer, or uphold the denial after considering all available documentation. It is then that the protest will go to the Independent Office of Appeals.

The NTA warns taxpayers that the Independent Office of Appeals does not consider information that the IRS didn't review first. Taxpayers should be careful to present all supporting information for their claim to the IRS during the audit process. Taxpayers that present new information they want Appeals to consider during its review will have their case sent back to the IRS.

Taxpayers who do not want to protest their claim disallowance to Appeals may file a lawsuit in U.S. district court or in the U.S. Court of Federal Claims within two years of receiving the claim disallowance notice. They do not need to seek a review by Appeals first. The two-year filing period begins running from the date on the notice.

H. IR 2024-216

The IRS reminds working parents that sending a child to a summer day camp may allow a taxpayer to claim the Child and Dependent Care Credit on their tax return to help offset expenses. The child must be under age 13, or of a qualifying dependent of any age, so they can work or look for work. This includes paying for a child's day camp, even if the camp specializes in a particular activity such as a sport. Only the costs of day camp are eligible, not overnight camps.

Taxpayers must have earned income to claim this credit. If married, both spouses must be working or seeking work, unless one is a full-time student or disabled.

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GROUP STUDY MATERIALS

A. Discussion Problems

- 1. Your clients, Jamie, Inga, and Delmar (brothers and sister), are members of a partnership, JID Partners. They are considering bringing in a tax-indifferent company as a partner and have asked you about the §754 election after hearing of all the positive benefits. Are there any potential downsides to making the election?
- 2. You have a new client who comes to you with a 2021 ERC claim that was prepared by a company they had heard of through the radio. They paid a significant fee to the company. The client received a \$950,000 credit but is now concerned that their business may not have qualified. You have reviewed the information and believe they do not qualify. How should you address this issue?
- 3. You have prepared the taxes for Miguel's business for many years. You had determined that he qualified for an ERC, but he comes to your office with a letter 105C disallowing the claim in its entirety. The letter does not mention any right to appeal the disallowance, and the IRS never conducted an audit. You believe that the ERC is correct. What action would you advise?

Required:

Discuss the issues fairly raised in the above fact patterns applying the material from this month.

B. Suggested Answers to Discussion Problems

- 1. Since making the election becomes irrevocable without IRS permission, which is not easily received, care must be made in making the decision to make a §754 election. While we often focus on the upside, there are also downsides. The IRS packet of guidance should be reviewed with the client as many common advantages, such as basis step-ups, may be considered transactions of interest requiring additional reporting. In addition, there is a clear intent to limit the advantages in related party situations which include tax-indifferent entities as related parties.
- 2. the ERC Voluntary Disclosure Program 2.0 allows the client to repay 85% of the money from the ERC and avoid penalties and interest. In addition, they could avoid any potential criminal action. A review of the eligibility requirements to determine if the client is eligible (they are essentially the same as the first VDP) is an advantageous way to address the issue.
- 3. Miguel has appeal rights even if the letter does not provide for them. Disallowed ERC appeals follow a different procedure. After receiving the protest, the IRS will conduct a post-protest audit of this ERC. If the taxpayer does not accept that decision, then it will go to Appeals.

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PART 2. INDIVIDUAL TAXATION

Key Considerations of Taxing Rental Real Estate: Part 2

In the second segment on rental real estate, we focus on the real estate professional exception from the passive activity rules, the Section 199A rental real estate safe harbor, and other miscellaneous issues.

Let's join Renée.

Ms. Rodda

Pretty much everyone wants to argue that they are real estate professionals. I think the problem is that the rules for real estate professionals are complicated. Even the IRS and the courts are not consistent in applying these rules. So, we see a lot of audits in this area. Because it's not clearly spelled out in the case law and because the IRS isn't really consistent, it's very hard to say this will or will not be successful. What I will tell you is that anytime you take large losses or regular losses year after year, your clients are likely to be audited, so you want to make sure you understand the rules and you're prepared to defend your client's position. Even if you do everything right, that doesn't mean that your clients won't be audited. That doesn't mean that there aren't areas where we've seen one taxpayer prevail and another taxpayer lose with a very similar set of facts. That's just the unfortunate reality of what we have here.

So, if your clients are not real estate professionals, and we'll walk through those rules in just a moment, when your client sells their rental property, it will free up suspended passive losses associated with that property. You report that on the Form 4797 so they can see why those passive losses were freed up. Again, I think in most cases, your tax software is handling this for you. It's always good to understand why things show up in different places. Let's talk about what we have to do to be a real estate professional.

To achieve real estate professional status, an individual has to meet two tests. They have to spend more than one half of their personal services during the year in real property trades or businesses. This is the test that knocks nearly all of your clients out of real estate professional status. Anyone who has a full-time job is not going to qualify as a real estate professional because if I have a full-time job, working 2,080 hours a year, probably more in a lot of cases, but let's just say 2,000 hours a year for a nice round number, I'm going to have to be also working in a real property trade or business for more than 2,000 hours per year. There's only so many hours in the day. So, if you have someone who has a full-time job in a non-real property trade or business, they are not going to be a real estate professional.

If you have someone who has a full-time job in a real property trade or business, they may be a real estate professional, but we still have to be able to show that they spend at least 750 hours of their personal services in real property trades or businesses. Let's take a look at this. If they become a real estate professional, they can only deduct losses for activities that they materially participated in. We'll talk about material participation in just a moment. Their hours working as an employee only count if they are at least a 5% owner in the business. If we have a married couple, one spouse has to meet both tests. So, let's go back for just a minute, and let's say we have a situation where we have someone who has more than half of their personal services in a real property trade or business, and that more than half adds up to at least 750 hours.

If we have somebody who's retired, for example, and now they're handling their rental properties and they can say, "Yep, this is the only work that I do," but they have to get to that at least 750 hours test. We often see couples saying, "Well, together we get to 750 hours." Unfortunately, that's not the rule. They have to have one of them meet both tests. So, one of them has to have more than half of their services in a real estate trade or business and that has to be more than 750 hours.

The next thing we want to talk about is what is considered a real property trade or business? The real estate developers and redevelopers are considered real property trade or businesses. Construction; acquisition of real estate; rental activities; the operation, management, leasing, or brokerage, including real estate agents, are all considered real estate trade or businesses.

Keep in mind something: I said I have to spend more than half of my hours in a professional service that's for a real property trade or business. If I am an employee, I only get to count my hours working if I'm at least a 5% owner of the business. So, let's go back and, for example, I mentioned that real estate agents are considered real property trade or business. If I work as an employee as a real estate agent, I don't get to count that time unless I am a more than 5% owner. Now, if I am an independent contractor, that's a different rule. So again, we start talking about the nuances and you can see where we have an issue.

We have some cases for you on pages 1-17 and 1-18. We have an appraiser that didn't qualify as a real estate professional because he was an employee and not at least a 5% owner. A mortgage broker did not qualify because the court found that being a broker of mortgages was financial instruments, not real property, even though those mortgages were related to real property. For an attorney, I think it's going to depend on the type of work that that attorney is doing. So, I could say that I'm an attorney, I own my practice. If all of my work is real estate work, then I can easily make the argument. If I have a mixed bag practice, then I'm going to have to show that at least 50 % of my practice would be real estate. I'd really like to show at least 750 hours or more are real estate, and that that is more than 50% of my total. I think that's where it's going to get a little difficult for the attorneys.

Grouping activities: You can group activities for both the 50% test and the 750 -hour test. So, if I owned 10 rental properties and it truly was my job, then obviously not one of those activities is going to be more than 50% and hopefully not more than 750 hours. I can count all of my time working on those activities towards my real estate professional status.

Grouping activities for real estate professional status is different than making a single activity election for other purposes. We're going to talk about these elections that feel very similar but are different for different rules. I have one rule for purposes of, am I a real estate professional? I have another rule for, am I materially participating? I have yet another rule for the §199A safe harbor. All of these things look very alike, they sound very alike, but they have their nuances, and they mean different things for your clients and there's different limitations that apply. And that's where you have to keep track of all of those different items.

Once I've decided someone is a real estate professional, now in order for them to treat an activity as non-passive, I have to also show that they materially participate in that activity. Remember I said I can easily group my activities to show that I am a real estate professional. When we look at material participation, each rental activity is treated separately unless you make an election to aggregate them. You have to actually make an election to do that. There is sample language for you on page 1-19 in the box there at the top of the page. You file a statement with the tax return. That aggregating election is binding for all future years that the taxpayer qualifies, and you can only revoke it if there is a material change in the taxpayer's facts and circumstances. What that means is you can't say, "All right, I'm going to aggregate the activities this year because I have a loss that I want to be able to take advantage of, but next year I'm going to sell one activity..." — and we're going to talk about how when we make that aggregation election, those passive losses that are suspended can get trapped — "...and so in that year, I don't want to have the aggregation." Once you make the election, they're stuck with it. So that's something you really want to consider. Do we have some properties that are making money and some properties that are losing money? If we're trying to get to that material participation test, is it really benefiting us? We need to take a look at that overall picture for the client.

A lot of people say to me, well, wouldn't I just make this election for everyone? The answer is no, especially if they have previously suspended losses. If your clients are buying new activities and they're truly actively participating, let's say they sold their business, they're retired, but they really don't want to just sit around or travel or play golf or whatever it is that they've decided to do in their retirement. They want something to keep them busy, so they've invested in rental properties. They don't have any previously suspended losses, and we want them to truly be real estate professionals, and we want them to meet the material participation test. So, we're going to make that aggregation election that's sort of a no-brainer for them.

But let's say you have somebody who's owned a property for years, it's been a rental property that has made little income or because of depreciation, we have a lot of suspended losses sitting there. Now, if they acquire new properties and you make the aggregation election, those suspended losses are now split among all the interests. So, if they sell

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one property, it's not going to free up all of those passive losses. Take a look at the example that I have on page 1-20. Bill owns five rental properties and makes the election under §469 to group the properties starting in 2020. Prior to 2020, Bill had accumulated \$65,000 of suspended losses. Bill sells property number two in 2024. The \$10,000 of suspended losses are now split up between the remaining four properties. For simplicity's sake, he's going to allocate \$2,500 of the previously suspended loss to each property. You can see that's situation where for him, maybe it's worth it. We're talking about \$10,000. But if that were \$100,000, that's a different scenario.

We tend to want to make that election because we want your clients to be able to show that they are materially participating in the activity. There are seven tests for material participation, but your clients only have to meet one. The nice thing about material participation is unlike the real estate professional test, you can count a spouse's participation. Even if the spouse doesn't own the activity and even if the taxpayers are filing married filing separate.

Again, keeping track of these rules: If I want someone to be a real estate professional, I can only look at their activity. I can group their different activities together and it doesn't affect anything else. Once we've determined that we have a real estate professional, now we need to have material participation in each activity for it not to be passive. And now we have to meet one of those material participation tests for the activity. We can count both spouses' activities now, and we can make an aggregation election to say we want to look at the activity across all of the properties to be materially participating. But if we do that, keeping in mind that that affects all of those properties, it affects things like passive losses, and that's something we really want to take a look at what it means for your clients. So just a slight difference in those rules.

Let's go through the tests that we're going to apply. The tests are listed starting on page 1-20. I would say there are some of these tests that are more common than others. The 500-hour test is one that we see used fairly often. Unlike the 750-hour test for real estate professional status, we look at each property individually, unless we make that single activity election. But in this case, that 500 hours of work can be done by the taxpayer or their spouse. We don't get to count their agents, employees, or subcontractors, which is going to be a little different when we get to some of the other rules.

500 hours is still a significant number of hours. If this is the path that your clients are going to go, you want to keep a detailed log. I would say without a single activity election, unless your clients own a large property like an apartment complex or something like that, getting to the 500-hour test for one property is going to be a little difficult.

The next test that we can look at is "substantially all." We often see people arguing that they do substantially all of the work for the activity. This is something that a lot of your clients are going to be able to do to meet the test, but they have to consider the work that's done by property managers, landscapers, plumbers. The IRS is going to look at the expenses that are claimed and compare them to what you have listed in the activity log. I think if your clients have property managers, the odds of them meeting the real estate professional test and showing they materially participate is slim to none. We might have situations where they have landscapers or plumbers, etc., and they'll still meet this substantially all test, but that's just something you want to keep in mind. If you're going to say, do more work or almost all of the work for this property, you have to consider all of those little ancillary services because they do add up.

You could say I have the majority of the participation. I do more than 100 hours and not less than any other individual. Again, not as easy as it sounds because you're going to have to document the work that's done by the taxpayer and everyone else who does any work. So, similar to that substantially all test. You see as we go through this, unless your clients really own a large number of properties, or they're really doing all of the work on their properties, maybe our clients are really handy. Maybe they're doing their own yard work, their own repairs. We certainly see taxpayers in that situation, and then they're going to meet that real estate professional and majority parts and material participation test. Other taxpayers, I think it's a much bigger hurdle than they think.

There is a test called the significant participation activity test that, really, rarely applies.

We have a prior year's participation test. If you met one of the other tests in five of the prior 10 years, you still qualify. Let's say maybe your clients used to do all the work themselves and then recently they've had a decline in health or for one reason or another, or they had a major renovation so they didn't meet the test this year but they typically do, they still qualify.

The personal service activity test, again, rarely applies.

The one I think that we see as quite a good catch-all is what we call the facts and circumstances test. You can say that based on all of the facts and circumstances, the individual participates in the activity on a regular, continuous, and substantial basis. Maybe it's not 500 hours. Maybe I can't show you that I do substantially everything, but every day, every week, I am regularly doing work for this activity, and I have facts and circumstances to back that up. That is a legitimate argument.

I do like the checklist that we have on page 1-22, because I think this is sort of the questions your clients really need to be able to answer. Did you work them more than 500 hours in any rental activity during the year? Did you perform substantially all of the work in the activity? Were there any others who were doing work that would include outside services as well as a spouse? Did you work more than 100 hours and more than anyone else? Did you materially participate for any five of the last 10 years? Or if we look at all the facts and circumstances, I think this is a great summary, again, a great checklist to say to your clients, all right, even if I can argue that you are a real estate professional, do you meet one of these tests? Because that's what we need to avoid this being a passive activity.

For all of this, we're talking about counting hours and keeping logs. Even if you can get your clients to be very disciplined and keep all of those logs and information that they need to keep, which hours do we really get to count? So, let's take a look at the first case because I think this is a great example of the type of contradiction we see with real estate professionals. In the *Leyh* case, the court allowed a taxpayer to count the time she spent driving to her properties towards her 750-hour test. However, in the *Truskowsky* case, which was an older case, the court specifically said the taxpayer couldn't count the time driving. Neither case is a presidential decision, meaning you can't count to the *Leyh* case to say the IRS has to follow it. And the IRS isn't bound by the *Leyh* case. So, the IRS can point to the old case. It's just going to depend on who's auditing your client and where you stand. And if it's something that your client wants to fight, then you go to court and then you're stuck with what is the decision that the court's going to make? Because we don't know how that's going to go.

Managing or overseeing the work of others doesn't count for purposes of material participation. We are going to talk about the real property safe harbor for §199A. In that case, you do get to count those hours. Again, I think those nuances are where we start to have confusion as tax professionals. Real estate professional: I can group the time spent on their different activities to see if they're a real estate professional. Material participation: I don't get to group the time spent unless I make an election. I do get to count the time spent by a spouse, which I don't get to count for real estate professional status. For managing or overseeing activities, I don't get to count that time, even though I do for purposes of the §199A safe harbor. So, all of these rules look and feel the same, but they are slightly different.

Researching investments also does not count. A lot of people say, "Well, I spent X number of hours investigating the neighborhood or looking at investment properties, so I was materially participating in my activity." Anytime where you're researching an investment does not count towards that material participation time.

And the facts and circumstances test can save someone who's not a good record keeper, but it's going to be difficult. There's a case in there illustrating that.

If you take a look at the example that I have on page 1-24, here's a good example of the challenges in establishing material participation. Mick lives in Southern California and owns two residential rental properties in Oregon. Mick is unemployed and spends all of his time driving to and from his rental properties and investigating new properties. Mick performs most of the ordinary repairs and maintenance on the properties but has a management company that can respond to emergencies because he doesn't live near the properties. They also collect and deposit rent checks on the first of each month. Now, I don't know how many people are really collecting rent checks, maybe most people

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are just depositing those now. Absent a very detailed time log, Mick is going to have a difficult time proving material participation. The negative factors are the travel time and time investigating properties aren't counted towards material participation. He employs a management company and the properties, consisting of only two residential rentals, are 900 miles away. His favorable factors are lack of other employment and the fact that he performs most repairs and maintenance himself. He's going to need a lot of help reconstructing his time and records to support his real estate professional and material participation status.

We have a great flow chart for you on page 1-25. This is a very handy chart. The good thing is we sent you a PDF so you can easily zoom in on the page. It's a great way to walk through to help your clients understand why they probably aren't a real estate professional.

On pages 1-47 and 1-48, we have a discussion of §199A and the rental real estate safe harbor. I think many of you remember prior to the pandemic, many moons ago, when §199A was first enacted, there was a big debate over whether rental real estate qualified as a §199A activity. Only trade or business activities qualified for §199A, and there was lot of discussion about rental real estate. The good news is that we did get the safe harbor that tells us we can take a §199A deduction if the taxpayer — so the owner, and in this case, we get to add the activity of the agents — spends 250 or more hours of service on the enterprise, and they meet other requirements. Then they qualify for the safe harbor, and we get to take the §199A deduction for that activity.

Now, let's talk about the safe harbor requirements first. First of all, your clients have to keep separate books and records for each rental real estate enterprise. You have to 250 or more hours of services for each enterprise. Contemporaneous records have to be maintained, including time reports, logs showing the hours of the service, the type of service, and then the taxpayer has to attach an election statement to their return.

When I talk about separate books and records, they are not defined in the Rev. Proc. Other IRC provisions define separate books and records and say that they include books of original entry and both general and subsidiary ledger accounts or similar records. I think if your clients have a QuickBooks or Quicken type record, a spreadsheet, anything that's showing the money coming in and the money going out, that's going to qualify as books and records. Some people use the statements that can come from the bank account. I think again, as long as it is only for that activity, then that's good news and we can use that for purposes of the books and records.

Taxpayers who have multiple properties can maintain separate records during the year and then consolidate them at the end of the year for purposes of §199A. Now this goes back to my discussion earlier: we talk about where we can treat things as separate activities and where we have to make elections to treat them as the same activity, and how it affects other things. Real estate professionals, we can look at all of the activity together to see if they're a real estate professional, it doesn't affect anything else. Material participation: we have to make an election to aggregate those activities and it's going to affect the tax reporting of all of those activities. For §199A, we can make an election to treat them as one enterprise, but we can still keep separate books and records during the year because we're reporting these activities as separate Schedule E activities unless we've made an aggregation election for material participation. All of these things, again, we have to keep those different rules straight.

For this purpose, for the 250-hour requirement, different than material participation where the work has to be done by the taxpayer or their spouse, in this case, we get to count work that is done by employees or agents. It has to be 250 or more hours of rental services in any three of the five consecutive taxable years. If your clients have an enterprise that's less than four years old, it's per year. If your client buys an activity mid-year, there is no provision to prorate. So, if they buy in December, for example, they're not going to get it for that year, they'll get it for the next year probably.

We attach a statement to a timely filed original return. Most software does this automatically for you. We can't do this for any property that's used as a vacation home for any part of the year, property that's rented to a trade or business of the taxpayer or a commonly controlled passthrough entity (but there is a separate self-rental rule that benefits those taxpayers), property that has any portion treated as a specified service trade or business, or property subject to a triple net lease because we have a specific exclusion there as well.

We have a list of the services that count on page 1-51. We don't get to count investment activities. We do get to count the work done by owners, agents, or employees. There was a lot of discussion about how you would get property managers to fill out a log. The good news is you can provide a description of the service performed. You can estimate the time generally spent and then have records of the amounts that were paid for that service to support that information.

You get to combine the multiple properties for purposes of deeming it as an enterprise, but that has to continue unless there's a significant change in circumstances. That grouping only applies for §199A. We can't combine commercial and residential rentals. They have to be separate. Mixed use properties can be treated as one or can be bifurcated. Again, those activities remain separate for Schedule E purposes.

A reminder that for self-rentals, no safe harbor is required. Self-rentals are treated as part of the trade or business. That's not a new rule. That overrides our triple net lease problem if you charge yourself a triple net lease, and that applies to minority owners as well. It does not, however, circumvent the specified service trade or business rules. If you're operating a business in a specified service trade or business, then the self-rental income is also a specified service trade or business.

If we only have one single rental property, you're going to have to address this on a case-by-case basis. This is an issue for net investment income tax and §199A. I think my conservative position is that in most cases, that single rental property doesn't rise to the level of a trade or business, especially if they have a property manager. I'll use myself as an example. I have my first condo still as a rental property. I don't have a property manager, but it's in an association. I have a home warranty on it. I don't even have to collect rent checks. They deposit them monthly. There's no way I can argue that that activity rises to the level of a trade or business. But there is a discussion if you want to make the argument on page 1-56 about the factors that the IRS is going to look at. Issuing 1099s doesn't automatically mean that you are a trade or business, but they are a factor that would be considered.

You're going to have to show that you're involved in the activity with continuity and regularly, and that the taxpayer's primary purpose for engaging in the activity is for income and profit. Most courts are going to use a similar standard. And then make sure that your clients are maintaining records, documenting any work, and sending out 1099s if they're appropriate.

I get a lot of questions about, "My clients are an investor, they get a K-1 showing that the rental real estate is a trade or business for §199A purposes, how do I confirm this?" That's not your job. If the K-1 has 1099 information reported, the QBI, the W-2 wages, and the UBIA, then the entity determined that the activity qualifies and your client gets the §199A deduction. If they didn't include it, they determined that it does not. You can agree or disagree, but that's a decision that the entity makes, not you at the individual shareholder or partner level.

There is a discussion on pages 1-58 to 1-60 about avoiding partnership tax treatment. In some cases, taxpayers don't want to be treated as a partnership. They can do that. If all the members of what we call an unincorporated association — so your clients haven't formed a corporation, they own a property together, they don't want to be treated as a partnership — they can elect to be treated as individual owners and not as a partnership. They can make the election on Form 1065; they attach a statement. If they never made an election and they've just reported the income and treated things separately, then you can use the intent of the owners. The reason you may want to do this is some of them want to make different elections than others. There is nothing preventing that. It's not something we see all that often. I pointed it out here, but again, not something I think you're going to see a lot of.

The last thing I want to remind you of before we go today is the discussion of idle property. You can deduct rental expenses for vacant property, but it has to be in a period where you're getting the property ready to rent, you're in between tenants, or you've been trying to rent or sell the property and you haven't been able to do so. You don't get to just let a property sit there vacant and claim expenses on it like a rental property when it's really just a passive investment. There's a discussion of that for you there on pages 1-60 and 1-61.

October 2024 19

SUPPLEMENTAL MATERIALS

Rental Real Estate: Part 2

REAL ESTATE PROFESSIONAL

The real estate professional exception from the passive activity rules is one of the most misunderstood concepts of tax. Many tax professionals fail to get this correct, and the IRS and even the Tax Court have had mixed opinions on this exception. There was and still is very little consistency in how the IRS deals with this area. One thing that is certain, however, is if large rental losses are claimed on Form 1040, the IRS will look at it.

The key is either understanding the law and preparing your case or not taking the deduction when preparing the return.

The losses could be legitimate, such as from a sale of a property that had suspended loss carryovers, or the taxpayer may legitimately qualify as a real estate professional. When you are dealing with the former scenario, be sure that the sale of the rental is reported on Form 4797, Sales of Business Property, so that the system can match it up.

Alternatively, if you or your client thinks they are a real estate professional, be sure that you and your client know what is required to qualify and provide adequate substantiation to back up that position.

Net investment income tax

Having the activity treated as nonpassive also provides the extra benefit of having the income treated as business income, which is not subject to net investment income tax (NIIT).

Practice Pointer

This is especially important in the year the property is sold.

THE TESTS

To achieve real estate professional status, an individual must meet two tests:

- More than half of the personal services performed by the taxpayer during the year must be in real property trades or businesses; and
- At least 750 hours of the personal services performed by the taxpayer during the year must be in real property trades or businesses.
 (IRC §469(c)(7))

Practice Pointer

But qualifying as a real estate professional is not enough to overcome the passive loss limitations. The limitation will still apply unless the real estate professional materially participates in the rental real estate activity for which the loss is claimed.

Failure to do so means IRC §469(c)(7) does not apply, and losses are generally limited to \$25,000.

Employee hours

A taxpayer can only count their employee hours in a real estate trade or business if the taxpayer is at least a 5% owner in the business. (IRC \$469(c)(7)(D)(ii))

Verify that one spouse alone meets both of the following tests

Practice Pointer

For purposes of the real estate professional tests discussed immediately below, in the case of spouses filing a joint return, the hours worked by both spouses cannot be combined. The tests are only satisfied if either spouse separately satisfies each of the requirements. So, if one spouse provides 300 hours of personal services and the other spouse provides 500 hours of personal services, neither spouse can qualify as a real estate professional.

Similarly, if one spouse provides 750 hours of personal services but spends less than 50% of their work time in the real estate trade or business, whereas the other spouse didn't meet the 750- hour test but did meet the 50% test, neither spouse qualifies as a real estate professional.

50% test

More than half of personal services in all trades or businesses for the year must be performed in real property trades or businesses and rental real estate.

A "real property trade or business" includes:

- Development and redevelopment;
- Construction;
- Acquisition;
- Conversion;
- Rental;
- Operation;
- Management;
- Leasing; or
- Brokerage (including real estate agents, see *Agarwal v. Comm.*, TCS 2009-29). (IRC §469(c)(7)(C))

In *Calvanico v. Comm.* (TCS 2015-64), the Tax Court rejected the taxpayer's argument that he qualified as a real estate professional due to his work as a real estate appraiser for a large accounting firm. However, it's important to note that the Tax Court did not reject the argument because a real estate appraiser is not involved in a "real property trade or business." Rather, the Tax Court held that he didn't qualify because employees can only count their employee hours toward their personal service real property trade or business hours if they are a 5% owner in the employer's business.

In CCA 201504010, the IRS clarified that a mortgage broker of financial instruments does not qualify as a real estate professional.

We believe that whether an attorney can treat their legal work as a real property trade or business requires a facts and circumstances analysis. In *Stanley v. U.S.* ((November 12, 2015) U.S. Dist. Ct., W.D. Ark, Case No. 5:14-CV-05236), a U.S. district court ruled that an attorney who was more than a 5% owner and acted as president and general counsel of a property management company was engaged in a real property trade or business.

In contrast, in *Lengille v. Comm*. (TCM 2010-49), the Tax Court held that an attorney failed to qualify as a real estate professional because she failed to show that more than 50% of her time was spent on real estate activities rather than on her legal practice. However, the court failed to address whether legal work related to real estate transactions would qualify as real property trade or business personal service hours. Many commentators are stating that if the attorney's legal work is related to real estate activities, then these hours may count.

This is where most taxpayers fail the test

Most taxpayers who work full-time in another field fail to meet the 50% test. A full-time employee in a non-real property trade or business is considered to work at least 2,000 hours a year, 40 hours a week, 50 weeks a year. That would mean a taxpayer would need to log another 2,001 or more hours tending to the rental activity. This is not an easy feat as there are only 8,760 hours in a year.

The Tax Court consistently sides with the IRS in disallowing real estate professional classification when the taxpayer has a full-time job in a field outside of real estate. (*Penley, et ux. v. Comm.*, TCM 2017-65; *Escalante v. Comm.*, TCS 2015-47; *Hassanipour v. Comm.*, TCM 2013-88) However, if adequate records are maintained, a taxpayer working part-time in a non-real property trade or business can qualify. (*Windham v. Comm.*, TCM 2017-68; *Miller v. Comm.*, TCM 2011-219)

750-hour test

The taxpayer must spend more than 750 hours in real property businesses and rentals in which they materially participate.

Practice Pointer

Taxpayers can group their various activities to meet the 50% and 750-hour test. Unlike the grouping election that is required for the material participation test discussed below, no election needs to be made to group these activities. For example, if a taxpayer is a part-time employee of a property management company in which they are a partial owner and rents out three properties, they can combine their hours worked for the property management company with the hours they spent managing their own properties to determine if they meet the 50% and 750-hour tests (see *Miller v. Comm*, TCM 2011-219 and CCA 201427016).

MATERIAL PARTICIPATION

If the answer is yes to both tests discussed above, then the taxpayer next must evaluate whether they materially participated in each rental real estate activity to determine whether the activity is treated as passive or nonpassive. (Treas. Regs. §1.469-5T; *Gragg v. U.S.* (August 4, 2016) U.S. Court of Appeals, Ninth Circuit, Case No. 4:12-cv-03813-YGR)

Single-activity (grouping) election

In assessing a taxpayer's material participation, each rental property is treated as a separate activity unless the taxpayer makes an election to treat all rental activities as a single activity (the single-activity election). (IRC §469(c)(7)(A))

The single-activity election permits a taxpayer to treat all interests in rental real estate as one activity, thereby creating a single, bigger activity, and one for which it will be easier to meet the material participation test. (IRC §469(c)(7); Treas. Regs. §1.469-9(g)(3)) The election is binding for the

tax year in which it is made and for all future years in which the taxpayer is a qualifying taxpayer. (Treas. Regs. §1.469-9(g)) The election is made by filing a statement with the taxpayer's original income tax return. Simply aggregating losses from various rental activities and reporting them on the tax return is not a sufficient election.

Sample single-activity election

Pursuant to IRC §469(c)(7)(A) and Treasury Regulation §1.469-9, the taxpayer hereby elects to treat all of the taxpayer's interests in rental real estate as a single rental real estate activity for the tax year ended December 31, 20XX, and subsequent tax years. The taxpayer hereby declares themself a qualifying taxpayer for the tax year ended December 31, 20XX.

A taxpayer may revoke the election only in the taxable year in which a material change in the taxpayer's facts and circumstances occurs or in a subsequent year in which the facts and circumstances remain materially changed from those in the taxable year for which the election was made. To revoke the election, the taxpayer must file a statement with the taxpayer's original income tax return for the year of revocation. This statement must contain a declaration that the taxpayer is revoking the election under IRC § 469(c)(7)(A) and an explanation of the nature of the material change.

Suspended losses may be trapped

It's important to remember that if the taxpayer makes the single-activity election, any previously suspended losses are still suspended. If the taxpayer sells a property with previously suspended losses and that property is grouped with other properties, the losses do not get released on the sale of the single property.

Under IRC §469(g), all previously suspended losses are released on a complete disposition of the entire interest. If the property is grouped with other properties, then the entire interest is not considered sold. When this occurs, the previously suspended losses do not get released, but instead, they are allocated to the remaining properties.

Example of suspended losses

Bill owns five rental properties and makes the election under IRC §469(c)(7)(A) to group the properties starting in 2020. Prior to 2020, Bill had accumulated \$65,000 of suspended losses:

Property 1 (\$20,000)
Property 2 (\$10,000)
Property 3 (\$25,000)
Property 4 (\$5,000)
Property 5 (\$5,000)

Bill sells Property 2 in 2024. The \$10,000 of suspended losses are now split up between the remaining four properties. For simplicity, he will allocate \$2,500 of the previously suspended loss to each property.

The material participation tests

Under Treas. Regs. §1.469–5T, a taxpayer materially participates in an activity in a taxable year if they meet one of seven tests.

Spouse's participation

Unlike the real estate professional tests above, a taxpayer's participation in an activity can include their spouse's participation. This is true even if the spouse doesn't:

- Own any interest in the activity; and/or
- File a joint return with the taxpayer.

1. The 500-hour test

A taxpayer materially participates in an activity if the individual participates in the activity for more than 500 hours during such year. (Treas. Regs. §1.469-5T(1))

Unless a single-activity election is made, the 500-hour test is applied on a per-property basis, not for all properties as is the case for the 750-hour real estate professional test discussed above.

Interplay between 750-hour test and 500-hour test

Luis owns 10 rental properties and averages working on each property 10 hours per month, meaning that he meets the 750-hour real estate professional test. However, unless he elects to group the properties, he does not meet the 500-hour material participation test because he only works 120 hours on any given property throughout the year. Luis must look to the other material participation tests to determine whether he can treat his activity as nonpassive.

The 500 hours must be performed by the taxpayer. This means a taxpayer may not qualify if they have a substantial amount of the work performed on the property in any year by a contractor or property manager.

Practice Pointer

Make sure your clients keep detailed logs as to how their time was spent (see discussion below). The IRS and Tax Court carefully examine the logs to ensure that time claimed was actually spent. For instance, they may cross-check credit card statements and will question a taxpayer's claim that they worked all weekend on property maintenance when their credit card statement shows they were vacationing in Mexico that weekend.

2. The substantially all test

A taxpayer materially participates in an activity if the individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for such year. (Treas. Regs. §1.469-5T(2)) Taxpayers who hire a property manager will not likely qualify under this test.

Comment

Again, we need to focus on who is actually doing the work — are there landscapers, plumbers, electricians? This is easy for our client who is handy and does the majority of all repairs, maintenance, and cleaning. However, the client who simply chooses the paint and hires the painter may not qualify. Also make sure that your client's claims are consistent with the deductions claimed on their returns. Are there more expenses claimed for repairs and maintenance than are reflected on the time logs?

3. The majority participation test

A taxpayer materially participates in an activity if the individual participates in the activity for more than 100 hours during the taxable year, and such individual's participation in the activity for the taxable year is not less than the participation in the activity of any other individual (including individuals who are not owners of interests in the activity) for such year.

Comment

Although 100 hours is only 20% of the 500-hour test discussed above, when you weigh that against time spent on the property by other persons (e.g., gardeners, repair persons, maintenance workers), it is often not easy to meet this test.

If trying to qualify under this test, taxpayers not only have to document how many hours they spent on the property, but the amount of time gardeners, repair people, etc., also spent on the property.

4. The significant participation activity test

A taxpayer materially participates in an activity if the activity is a significant participation activity under Treas. Regs. §1.469-5T(c), and the taxpayer's aggregate participation in all significant participation activities exceeds 500 hours.

Comment

Remember that the material participation tests apply to all types of businesses, not just real estate activities, and the regulations don't allow real estate activities to qualify as a Treas. Regs. §1.469-5T(c) significant participation activity, so this would not apply.

5. The prior years participation test

A taxpayer materially participates in an activity in a tax year if the taxpayer met any of the other six material participation tests outlined during any five years out of the 10 years immediately preceding the tax year. The five years do not have to run consecutively.

Comment

This test can come into play in a year in which the activity does not require much hands-on participation by the taxpayer.

6. Personal service activity test

A taxpayer materially participates in an activity if the activity is a personal service activity under Treas. Regs. §1.469-5T(d), and the taxpayer materially participated in the activity for any three taxable years preceding the current tax year.

Comment

Similar to the material participation test #5 above, this test does not apply to real estate activities.

7. Facts and circumstances test

A person materially participates in an activity if, based on all of the facts and circumstances, the individual participates in the activity on a regular, continuous, and substantial basis during such year.

Material participation: the bottom line

A yes to any of the following, and the taxpayer materially participates:

- 1. Did the taxpayer work more than 500 hours in the rental activity during the year?
- 2. Did the taxpayer perform substantially all the work in the activity? Were there any others who were involved with this rental activity? This would include outside services, as well as a spouse.
- 3. Did the taxpayer work more than 100 hours and more than anyone else (including nonowners)? This is where we lose a few of our clients from qualifying. The 500-hour test is hard enough, but when you are dealing with a smaller number of hours, it would seem to be easier yet it is not. We need to closely examine what other services are being provided.
- 4. Did the taxpayer materially participate in the activity for any five of the last ten years? Again, this is where we can get a little relief in a year or two when we have good tenants and minimal time is required.
- 5. Under all the facts and circumstances, did the taxpayer work on a regular, continuous, and substantial basis in the activity? This goes back to the theory that it is allowable if the activity is "in the course of an ordinary trade or business."

COUNTING HOURS

Driving time may count

The Tax Court ruled that a taxpayer's log that was revised to include drive time to her rental properties could be used to prove she satisfied the 750-hour threshold to qualify as a real estate professional. (*Leyh v. Comm.*, TCS 2015-27)

The ruling in this case contradicts *Truskowsky*, a prior Tax Court case in which the court refused to count travel time because it represents commuting that "is an inherently personal activity and as such does not constitute 'work' in connection with a trade or business." (*Truskowsky v. Comm.*, TCS 2003-13) The IRS refused to accept the additional hours.

6[™] Caution

Neither *Leyh* nor *Truskowsky* may be cited as precedent as they are Tax Court Summary decisions. Therefore, a real estate professional may not rely on the *Leyh* decision in deducting expenses incurred in driving from the taxpayer's home to their rental properties. And, the IRS may not rely on *Truskowsky*.

Management activities do not count

Managing and overseeing another's work generally does not count toward satisfying the hour requirements outlined above. (Treas. Regs. §1.469-5T(b)(ii); *Hairston v. Comm*, TCM 2019-104)

Investment research and education hours

Work done by an individual in the individual's capacity as an investor in an activity does not count unless the individual is directly involved in the day-to-day management or operations of the activity. (Treas. Regs. §1.469-5T(f)(ii))

In *Padilla v. Comm.*, TCS 2015-38, although a taxpayer presented a time log showing 764 hours spent in the real estate trade or business, he failed to qualify as a real estate professional. After reviewing the log, the court found that many of the hours claimed were investor-related time, which doesn't count even if the investor time relates to real estate investments.

Padilla, a part-time IT specialist, owned five single-family residence rental properties. Because of the extra time available due to no longer having a full-time job and the overall economic downturn that was impacting his rental properties, he spent more time trying to refinance his rentals and in other activities related to the property. He reported 764 hours working in the rental activity.

Under Treas. Regs. §1.469-5T(f)(2)(ii)(A), these activities performed by Padilla are considered investor activities (and therefore do not count toward the hours spent):

- Research into properties near properties already owned;
- Refinance research;
- Foreclosure research; and
- Researching new businesses.

In *Barniskis*, the Tax Court found that the following activities were also investor activities:

- Organizing personal records;
- Preparing their taxes;
- Paying bills; and
- Reviewing their monthly statements of their rentals. (*Barniskis v. Comm.*, TCM 1999-258)

FACTS AND CIRCUMSTANCES CAN SAVE BAD RECORDS

A disabled veteran won his real estate professional case because he personally performed all activities related to managing and maintaining a triplex apartment near his home. (*Lewis v. Comm.*, TCS 2014-112) Taking into consideration the taxpayer's disabilities, the Tax Court rejected the IRS's contention that it was highly unusual to achieve real estate professional status for a taxpayer who only owned a single small property. The taxpayer did not have a log but estimated the time he spent and gave a narrative summary of the services he performed. For example, on Mondays he would clean the washhouse, and on Tuesdays and Fridays he did the landscaping and cleaned.

The court disagreed with the IRS's contention that the total time spent was less than 750 hours, but the taxpayer prevailed because based on his age and disability, the activities would likely take longer.

In another case, a taxpayer's material participation was determined based on all the facts and circumstances. In *Hailstock*, the taxpayer filed income tax returns for multiple years at one time. (*Hailstock v. Comm.*, TCM 2016-146) The IRS audited the taxpayer, and due to her scarce records, determined deficiencies based on a bank deposits analysis. The IRS also denied her determination that she was a real estate professional that materially participated in her real estate activities.

Thankfully for Ms. Hailstock, a taxpayer must only meet one of the material participation tests. One of those tests treats a taxpayer as materially participating in an activity for a tax year if,

based on all the facts and circumstances, the taxpayer participates in the activity on a regular, continuous, and substantial basis. (Treas. Regs. §1.469-5T(a)(7)) Despite Ms. Hailstock's poor records, the Tax Court found her testimony regarding her activities credible and held that she was a real estate professional that materially participated in her rental activities. The court found persuasive the fact that she owned many properties and did not have other employment.

Practice Pointer

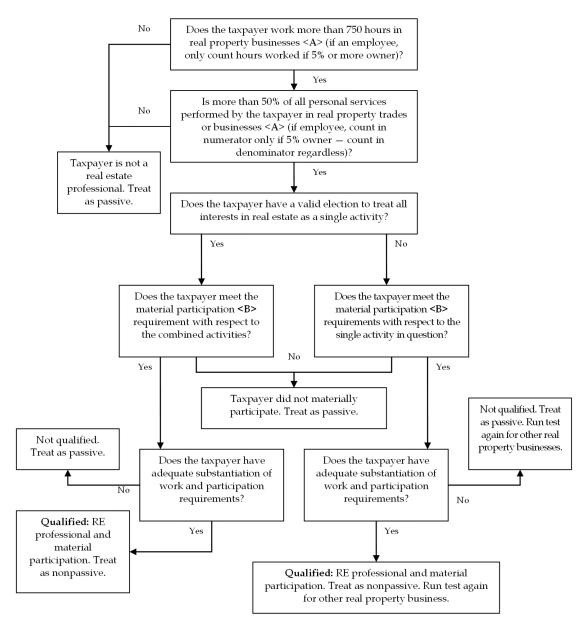
Most taxpayers maintain better records than Ms. Hailstock, but most are also likely missing time records or logs to determine material participation. Using the facts and circumstances test, practitioners can help document their client's time spent well before an audit. Factors that may help determine material participation are multiple properties, lack of other employment, activities located close enough to the taxpayer to enable their reasonable management (not 200 miles away), and absence of a management company.

Example of challenges in establishing material participation

Mick lives in southern California and owns two residential rental properties in Oregon. Mick is unemployed and spends all his time driving to and from his rental properties and investigating new properties. Mick performs most ordinary repairs and maintenance on the properties himself but has a management company that can respond to emergencies and collect and deposit rent checks on the first of each month.

Absent a very detailed time log, Mick will have a difficult time proving material participation. Negative factors are that travel time and time investigating properties aren't counted toward material participation, he employs a management company, and the properties, consisting of only two residential rentals, are 900 miles away. Favorable factors are Mick's lack of other employment and the fact that he performs most repairs and maintenance himself. In this example, Mick will need a lot of help reconstructing his time records.

Real estate professional flowchart



<A> Real property businesses include: Rental

Development Redevelopment Construction Reconstruction

Acquisition

Conversion

Operation Management Brokerage

 To materially participate you must meet one of the following tests:

- Spend more than 500 hours in the activity
- Perform substantially all the work in the activity
- Spend more than 100 hours in the activity, and no one else does more
- Spend more than 100 hours and aggregate more than 500 hours in significant participation activities
- Materially participate in the activity any 5 of the last 10 years
- The activity is a personal service activity
- 7. Facts and circumstances support regular, continuous, and substantial participation * Note: Limited partners may only use tests 1, 5 and 6

Supplement Materials CPE Network® Tax Report

IRC §199A RENTAL REAL ESTATE SAFE HARBOR (NOTICE 2019-38)

The rental real estate safe harbor provides taxpayers with an administrative method of proving whether rental real estate is deemed to be a trade or business for purposes of IRC §199A. (Rev. Proc. 2019-38) Only activities that are deemed to be trades or businesses are eligible for the IRC §199A deduction.

Under the safe harbor rule, the owner of a rental real estate enterprise may take an IRC §199A deduction if the owner and/or their agents spend 250 or more hours of rental service on the enterprise and meet other requirements.

Revenue Procedure 2019-38 emphasizes that if an enterprise fails to satisfy the safe harbor requirements, then the rental properties that make up the rental real estate enterprise may still be treated as trades or businesses for purposes of IRC §199A if those rental properties otherwise meet the definition of a trade or business under Treas. Regs. §1.199A-1(b)(14). That regulation defines a trade or business as a trade or business under IRC §162 other than the trade or business of performing services as an employee.

Passthrough entities may also use the rental real estate safe harbor to determine whether a rental real estate enterprise is a trade or business at the entity level.

Practice Pointer

It is up to the person or entity that actually owns the property to determine whether a rental activity is a trade or business. As such, the decision to apply the safe harbor rule is made by the property owner.

For example, if an LLC owns a commercial rental property and reports each member's share of the net rental income on Schedule K-1, then the LLC is the one that must determine whether the rental property is a trade or business for IRC §199A purposes. The individual members of the LLC cannot make their own separate trade or business determination.

If the LLC determines that the rental property is a trade or business (by using the safe harbor or by using Treas. Regs. §1.199A-1(b)(14)), then the LLC will also report IRC §199A items on each member's K-1.

THE SAFE HARBOR REQUIREMENTS

There are four requirements to meet the rental real estate safe harbor:

- 1. Separate books and records must be maintained to reflect income and expenses for each rental real estate enterprise;
- 2. 250 or more hours of rental services must be performed per year with respect to each rental real estate enterprise;
- 3. Contemporaneous records must be maintained, including time reports, logs, or similar documents, regarding:
 - a. Hours of services performed;
 - b. Description of services performed;
 - c. Dates services were performed; and
 - d. Who performed the services; and
- 4. The taxpayer must attach an election statement to their return.

Taxpayers must meet the rental real estate safe harbor requirements annually.

Separate books and records

Revenue Procedure 2019-38 does not define the term "separate books and records." The only place in the Code and Treasury Regulations that defines separate books and records is found in Treas. Regs. §1.989-1(d)(1), dealing with definitional and special rules for purposes of foreign

currency transactions. Foreign currency transactions are completely unrelated to rental real estate enterprises, but it's the closest we're going to get.

Separate books and records include books of original entry and both general and subsidiary ledger accounts or similar records. For example, in the case of a taxpayer using the cash receipts and disbursements method of accounting, the books of original entry include a cash receipts and disbursements journal where each receipt and disbursement is recorded. (Treas. Regs. §1.989-1(d)(1))

Similarly, in the case of a taxpayer using an accrual method of accounting, the books of original entry include a journal to record sales (accounts receivable) and a journal to record expenses incurred (accounts payable).

In general, a journal represents a chronological account of all transactions entered into by an entity for an accounting period. A ledger account, on the other hand, chronicles the impact during an accounting period of the specific transactions recorded in the journal for that period upon the various items shown on the entity's balance sheet (i.e., assets, liabilities, and capital accounts) and income statements (i.e., revenues and expenses). (Treas. Regs. §1.989-1(d)(1)) This requirement also makes keeping the books easier and better for the taxpayers.

Comment

Revenue Procedure 2019-38 provides some additional clarity to the separate books and records requirement. It states:

"If a rental real estate enterprise contains more than one property, then the separate books and records requirement may be satisfied if income and expense information statements for each property are maintained and then consolidated."

When multiple properties are combined into a single rental real estate enterprise, they are only combined for purposes of the IRC §199A deduction calculation. Each individual property in the rental real estate enterprise must still be reported separately on Schedule E (or Form 8825, Rental Real Estate Income and Expenses of a Partnership or an S Corporation, in the case of a partnership or S corporation). So how could multiple properties maintain one set of books and records for one purpose (IRC §199A) but still be reported independently for another purpose (Schedule E/Form 8825)?

By allowing taxpayers to consolidate books and records for each of the properties in their rental real estate enterprise at the end of the year, the IRS has effectively eased the taxpayer's administrative burden.

250-hour requirement

If a rental real estate enterprise has been in existence for less than four years, then the taxpayer must perform 250 or more hours of rental services per year with respect to the rental real estate enterprise. (Rev. Proc. 2019-38)

For rental real estate enterprises that have been in existence for at least four years, the taxpayer must perform 250 or more hours of rental services in any three of the five consecutive taxable years that end with the taxable year at issue.

Rental activities lasting less than 12 months

The rental real estate safe harbor does not contain any provision permitting taxpayers to prorate the 250-hours-or-more requirement in years where a rental real estate enterprise is owned for less than

a full year. Absent such a provision, taxpayers must meet the full 250-hours-or-more requirement for their real estate enterprise regardless of whether the enterprise is owned for part of the year.

Election statement

To take advantage of the rental real estate safe harbor, the taxpayer or passthrough entity must attach a statement to a timely filed original return for each taxable year in which the taxpayer or passthrough entity relies on the safe harbor.

The statement must include the following information:

- A description (including the address and rental category (commercial or residential) of all rental real estate properties that are included in each rental real estate enterprise;
- A description (including the address and rental category) of rental real estate properties acquired and disposed of during the taxable year; and
- A representation that the requirements of Revenue Procedure 2019-38 have been satisfied.

Single statement for all rental real estate enterprises

An individual or passthrough entity with more than one rental real estate enterprise relying on Revenue Procedure 2019-38 may submit a single statement, but the statement must list the required information separately for each rental real estate enterprise. Most professional tax software products will produce the required statement automatically.

Excluded real estate

There are four rental real estate arrangements that are excluded from the safe harbor:

- 1. Property used as a residence by the taxpayer for any part of the year under IRC §280A (vacation home rules);
- 2. Property rented to a trade or business conducted by a taxpayer or a passthrough entity which is commonly controlled under Treas. Regs. §1.199A-4(b)(1)(i);
- 3. Property that has any portion treated as a specified service trade or business (SSTB) under Treas. Regs. §1.199A-5(c)(2), which provides special rules where property or services are provided to an SSTB; and
- 4. Property subject to a triple net lease. In a triple net lease, the owner, by contract with the tenant, has shifted the burden of upkeep and maintenance to the lessee. Therefore, the owner only has to cash a check.

Revenue Procedure 2019-38 defines triple net leases for purposes of excluding them from the rental real estate safe harbor as: "a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to pay for maintenance activities for a property in addition to rent and utilities."

RENTAL SERVICES

Rental services that count toward the 250-hour requirement and that are specifically listed in Revenue Procedure 2019-38 and Notice 2019-07 include time spent on the following activities:

- Advertising to rent or lease the real estate;
- Negotiating and executing leases;
- Verifying information contained in prospective tenant applications;
- Collection of rent;
- Daily operation, payment of expenses, maintenance, and repair of the property, including the purchase of materials and supplies;
- Management of real estate; and
- Supervision of employees and independent contractors.

Rental services that do not count toward the 250-hour requirement include financial or investment activities, such as:

- Arranging financing;
- Procuring property;
- Studying reports on operations;
- Planning, managing, or construction of long-term capital improvements; or
- Hours spent traveling to and from the real estate.

Who performs the services?

Revenue Procedure 2019-38 states that rental services may be performed by owners, including owners of a passthrough entity, or by employees, agents, and/or independent contractors of the owners.

If the taxpayer can count an agent's hours of services, then, presumably, the taxpayer can count an agent's agent's hours of services. So, if the property owner hires a property manager and the property manager hires a gardener, the property owner can count the hours spent by both the property manager and the gardener.

The property manager and agent challenge

Properties managers, gardeners, plumbers, etc., do not typically maintain and provide time logs for the work they perform, but contemporaneous time logs are required if the taxpayer wants to count the work performed by their agents for the 250-hour requirement.

Revenue Procedure 2019-38 provides that if rental services are performed by employees or independent contractors, then the taxpayer is only required to provide:

- A description of the rental services performed by the employee or independent contractor;
- The amount of time such employee or independent contractor *generally* spends performing such services for the rental real estate enterprise; and
- Time, wage, or payment records for such employee or independent contractor.

Comment

Revenue Procedure 2019-38 that allows taxpayers to estimate time spent by agents, such as property managers, should be a great relief to taxpayers.

Example #1 of performing services

John and Mitchy own an office park as tenants-in-common, and each owns 50%. John is retired on an exotic beach somewhere in the Caribbean, and Mitchy works full time managing the office park.

As tenants-in-common, John and Mitchy must each report their respective share of the income and expenses of the office park on Schedule E of their personal income tax returns. As such, each must apply the 250-hour-ormore requirement and attach the required statement to each of their returns pursuant to Revenue Procedure 2019-38.

John and Mitchy both satisfy the 250-hour-or-more requirement based on the time spent by Mitchy. His time spent is countable both for himself and for John because he is acting as John's agent when he manages the property they both own.

Example #2 of performing services

What if John and Mitchy own the office park in an LLC?

In this scenario, the LLC, not the individual members, must meet the requirements of Revenue Procedure 2019-38, and it is the LLC that attaches the required statement to its income tax return.

WHAT IS A RENTAL REAL ESTATE ENTERPRISE?

Solely for purposes of the 250-hours-or-more safe harbor (Rev. Proc. 2019-38), a rental real estate enterprise is defined as an interest in real property held for the production of rents. A taxpayer may combine multiple properties into a single enterprise, but if they do so, they must continue this treatment from year to year unless there has been a significant change in facts and circumstances.

Combine rental properties under safe harbor versus aggregation

Properties combined into a "rental real estate enterprise" and the aggregation rules are not the same. They are separate sets of rules that operate independently of one another. The aggregation rules are used to treat multiple trades or businesses as a single trade or business for IRC §199A calculation purposes.

The rental real estate safe harbor rules of Revenue Procedure 2019-38 are used to combine multiple rental properties into a single trade or business. In essence, when multiple rental properties are combined into a single rental real estate enterprise (a single trade or business), then they are effectively aggregated already, and taxpayers do not need to meet the aggregation requirements nor report the multiple properties on Schedule B to Form 8995-A, Qualified Business Income Deduction.

Both of these grouping rules only apply for purposes of IRC §199A.

Two types of rental real estate categories

Revenue Procedure 2019-38 defines two rental real estate enterprise categories:

- · Residential; and
- Commercial.

Commercial and residential property <u>cannot</u> be combined into the same enterprise. Thus, for purposes of the safe harbor, a taxpayer with both residential and commercial properties must meet the safe harbor requirements separately with respect to each type of property.

Example of multiple properties

Zal owns one residential apartment building, three residential houses, and two pieces of commercial rental property. He keeps one set of books for the apartment building and the house rentals and a separate set of books for the commercial properties. His time spent in 2023 was as follows:

	Residential	Commercial
Apartment building	125 hours	
Rental house 1	50 hours	
Rental house 2	50 hours	
Rental house 3	25 hours	
Commercial property 1		50 hours
Commercial property 2		<u>100 hours</u>
Total	250 hours	150 hours

Zal can combine his residential rental properties into a single enterprise and meet the 250-hour safe harbor.

His commercial rentals do not qualify for the safe harbor even if he combines them together because he does not spend at least 250 hours on them, but they may still qualify as a trade or business under IRC §162.

Mixed-use properties

Interests in mixed-use properties may be treated as a single rental real estate enterprise or may be bifurcated into separate residential and commercial interests. (Rev. Proc. 2019-38)

Revenue Procedure 2019-38 defines mixed-use properties as a single building that combines residential and commercial units.

An interest in mixed-use property, if treated as a single rental real state enterprise, may not be part of the same enterprise as other residential, commercial, or mixed-use properties.

Example of mixed-use properties

Denny owns three rental properties:

- A residential duplex;
- A retail strip mall (commercial property); and
- A five-story building that contains retail on the ground floor and apartments above it (mixed-use property).

Assuming Denny meets the other rental real estate safe harbor requirements, she can:

- Treat each rental property as its own separate rental real state enterprise (one residential, one commercial, and one mixed-use); or
- Bifurcate her mixed-use property and combine the residential portion with her duplex and combine her commercial portion with her strip mall.

Schedule E reporting

Taxpayers that combine rental properties together into a single rental real estate enterprise for purposes of meeting the 250-hour-or-more safe harbor must still report the rental income and expenses of each property separately on Schedule E. This is because properties combined into a single rental real estate enterprise are deemed to be a single trade or business only for purposes of calculating the IRC §199A deduction. They are not treated as a single trade or business for *any* other purpose.

ESTABLISHING "TRADE OR BUSINESS" WITHOUT THE SAFE HARBOR

Self-rentals

If rental real estate activities are rented or leased to a commonly controlled taxpayer (Treas. Regs. §1.199A-4(b)(1)(i)) and the rental property is used in an operating trade or business ("self-rental"), then the rental real estate is treated as part of the operating business. (Treas. Regs. §1.199A-1(b)(14))

Example of self-rental

Cass and Sebastian are married and own a rental property. The property is rented to the tax practice that Cass operates as an S corporation.

Because the rental property is a self-rental, it is treated as part of its related business. As such, the property rented to the tax practice is deemed to be a trade or business (the rental real estate safe harbor is unnecessary). Thus, rental income from the property rented to the tax practice is qualified business income. For Cass, this means that the rental income is also SSTB income.

When performing the IRC §199A calculation, the QBI, W-2 wages, and unadjusted basis immediately after acquisition (UBIA) of the rental property and tax practice must be combined into a single trade or business.

The self-rental rules override the triple net lease conundrum

If a property is a self-rental but is leased under a triple net lease scenario, then the rental property is still deemed to be part of the commonly controlled operating business. This is because triple net leases are not precluded from being classified as a trade or business. Taxpayers are simply prevented from using the rental real estate safe harbor to establish it.

Rental real estate safe harbor is irrelevant where self-rentals are involved

Likewise, if a self-rental is part of an operating business that is a trade or business, then the 250-hour-or-more safe harbor is not required because the rental property is automatically deemed to be a trade or business.

Minority investors are affected, too

Minority owners of a rental property are affected by the self-rental rules as well. This is because the determination of whether a rental property is a trade or business is made for the property as a whole. So, if the majority owner of the rental property leases it to their own business, then under the self-rental rules, the entire rental property is deemed to be a trade or business.

Example of minority owners of self-rental properties

Daniel and Joshua are partners in a law firm that operates as a limited liability partnership. Daniel owns 80% and Joshua owns 20%.

Daniel and Christian are members of an LLC that owns the office building for Daniel and Joshua's law firm. Daniel owns 60% of the LLC and Christian owns 40%.

The law firm and the LLC are commonly controlled by Daniel. Therefore, the LLC's rental income from the office building is deemed to be a trade or business. Christian, as the 40% owner of the office building, can benefit from this determination if the property produces net income (QBI). Christian may be harmed if the property produces negative QBI.

Comment

Interestingly, it appears that the rental income to Daniel is SSTB income, but it is not SSTB income to Christian (see Treas. Regs. §1.199A-5(c)(2)(i)).

The determination of whether a business is an SSTB is made based on the activity of the business as a whole. But Treas. Regs. §1.199A-5(c)(2)(i) provides that "if a trade or business provides property or services to an SSTB ... and there is 50% or more common ownership of the trade or business, that portion of the trade or business of providing property or services to the 50% or more commonly owned SSTB will be treated as a separate SSTB with respect to the related parties [emphasis added]."

Using self-rental to circumvent SSTB rules?

Rental real estate that qualifies as a trade or business generates non-SSTB QBI. Further, income from self-rentals is automatically deemed to be a trade or business. Some practitioners have asked whether this means that owners of an SSTB can rent space to their SSTB and generate non-SSTB QBI.

Not exactly—the aforementioned rules apply here as well. Because the operating business is an SSTB, the rental income generated from the self-rental is also income from an SSTB, but only as to the related parties. (Treas. Regs. §1.199A-5(c)(2)(i))

Comment

The discussion here revolves around real property rentals, but the self-rental rules apply to the rental or licensing of tangible and intangible property as well.

Single rental properties

One of the most common questions we're asked is whether a taxpayer with a single rental property qualifies to claim the qualified business income deduction, especially where the safe harbor is not available or cannot be satisfied.

There is no clear answer. There are no Tax Code sections that define "trade or business," and prior case law and guidance has been scarce, conflicting, or nonexistent.

The reason is that under current law, deductions are generally the same whether a single rental is treated as a "trade or business" or an "investment property."

Rental real estate enjoys all the benefits of trade or business treatment even if it is classified as investment property and then some. Like trades or businesses:

- Taxpayers can take deductions above line, including depreciation (IRC §212);
- Losses on dispositions are IRC §1231 and are, therefore, ordinary losses that can generate NOLs; and
- Unlike other trades or businesses, income is exempt from self-employment tax. (IRC §1402(a))

Therefore, taxpayers have had little incentive to force a determination as to whether rental real estate is a trade or business until IRC §199A came about.

Similar to NIIT trade or business exception

Like IRC §199A, the net investment income tax (NIIT) presents an issue for taxpayers as to how to treat income from single rental properties. Although income from rents is subject to the NIIT, there is an exclusion if the rents are received by a trade or business.

While to date there are no court decisions addressing whether a single rental is a "trade or business" for purposes of the NIIT, the IRS did address this issue in the preamble adopting the final NIIT regulations. (T.D. 9644) Like the IRC §199A deduction, the IRS applies an IRC §162 analysis to determine whether the rental activity rises to the level of a "trade or business." And like IRC §199A, the IRS refused to adopt a bright-line test for purposes of determining when a rental activity rises to the level of a "trade or business."

The IRS did state that in making a trade or business determination it will look at:

- The type of property (commercial real property versus a residential condominium versus personal property);
- The number of properties rented;
- The day-to-day involvement of the owner or its agent; and
- The type of rental (for example, a net lease versus a traditional lease, short-term versus long-term lease).

The IRS listed these same criteria in the preamble adopting the final IRC §199A regulations.

In an example, the IRS also stated that an individual who owned a commercial building and rented it out for \$50,000 but was not involved in the activity of the commercial building on a "regular and continuous basis" was not involved in the conduct of a trade or business.

Filing 1099s

The IRS did not specifically list that filing a 1099 to report services purchased for the property was a determining factor. However, the IRS did note that they will "closely scrutinize situations where taxpayers take the position that an activity is a trade or business for purposes of the net investment income tax (IRC §1411), but not a trade or business for other such provisions.

"For example, if a taxpayer takes the position that a certain rental activity is a trade or business for purposes of IRC §1411, the IRS will take into account the facts and circumstances surrounding the taxpayer's determination of a trade or business for other purposes, such as whether the taxpayer complies with any information reporting requirements for the rental activity imposed by IRC §6041."

So, it appears that the filing of the 1099s may not establish that a rental property is a "trade or business," but the failure to file them may be used against a taxpayer claiming they are operating a trade or business.

Groetzinger standard

When determining whether any activity is a trade or business or an investment, courts and commentators alike turn to the 1987 *Groetzinger* case. (*Comm. v. Groetzinger* (1987) 480 US 23) In this case, the U.S. Supreme Court examined whether a full-time gambler was in the trade or business of gambling and therefore not subject to AMT. The court found that Groetzinger, who devoted between 60–80 hours a week wagering on dog races, was in a trade or business. In making that determination, the court stated that to be engaged in a trade or business, the taxpayer:

- Must be involved in the activity with continuity and regularity; and
- The taxpayer's primary purpose for engaging in the activity must be for income or profit.

The court also stated that whether an activity rises to the level of a trade or business "requires an examination of the facts in each case."

Trade or business rental cases

Most of the U.S. district and appellate courts use a standard similar to the *Groetzinger* standard, requiring a finding of some form of continuous and regular activity in relation to the rental property before finding that the taxpayer was engaged in a trade or business. The one exception is the Seventh Circuit's decision in *Reiner v. U.S.*, in which the court adopted the Tax Court's *Lagreide* reasoning that the owning of a single rental property amounts to a "trade or business." (*Reiner v. U.S.* (1955) 222 F.2d 770; *Lagreide v. Comm.* (1954) 23 TC 508)

The Tax Court had historically adopted the position taken in *Lagreide*. However, in 1980, the Tax Court too began following a similar position as the other federal appellate and district cases. In *Curphey v. Comm.*, the Tax Court allowed a dermatologist to claim a home office deduction because the taxpayer used the office in relation to managing six rental properties. (*Curphey v. Comm.* (1980) 73 TC 766) The court noted that his activities in screening tenants, supplying furnishings, and maintaining the units were "sufficiently systematic and continuous to place him in the business of real estate."

The Tax Court reached the opposite conclusion but applied the same standard in *Anderson v. Comm.* in 1982, in which another dermatologist rented out farmland, finding that the taxpayer simply leased the farmland to a tenant farmer and relieved himself of all responsibilities for the land and that he failed to "establish that his activities were sufficiently regular, systematic, and continuous as to place him in the business of farm management." (*Anderson v. Comm.*, TCM 1982-576)

Similarly, in *Jafarpour v. Comm*. in 2012, the Tax Court denied GO-Zone bonus depreciation to California taxpayers who purchased three rental properties in Louisiana and Alabama. (*Jafarpour v. Comm.*, TCM 2012-165) The court noted that the taxpayer simply reviewed rental agreements and left all management of the properties to property managers. (Note: Other court cases have found that the property managers were agents of the taxpayers, and the managers acted as the taxpayers' agents for purposes of establishing the requisite level of continuous and regular activities.)

Substantiating a trade or business

While we feel it is possible to establish a rental activity as a trade or business even if the taxpayer and their agents do not meet the 250-hour threshold of Revenue Procedure 2019-38, it's important that the taxpayer conduct its activities in a business-like manner. This means:

- Establishing separate accounts for the activity;
- Documenting what work was done and time spent (both for the taxpayer and any agents such as property managers, repair persons, landscapers, etc.); and
- Sending out Forms 1099-MISC if appropriate.

SAFE HARBOR K-1 REPORTING

Revenue Procedure 2019-38 does not require a passthrough entity to provide specific disclosure on the K-1s it issues to its owners or beneficiaries. Therefore, if a passthrough entity combines two or more properties together into a single rental real estate enterprise (and therefore a single qualified trade or business) for purposes of the safe harbor, it must report the QBI, W-2 wages, and UBIA for the combined rental properties as a single line item.

As previously discussed, the safe harbor rules are not the same as the aggregation rules. Treas.

Regs. §1.199A-4(b)(2)(ii), (c)(3) and (c)(4) discuss aggregation of trades or businesses by a passthrough entity and K-1 reporting of that aggregation on Schedule K-1.

Passthrough entities must attach a statement to each Schedule K-1 identifying each trade or business aggregated by the entity. But combining properties for purposes of meeting the 250-hour safe harbor is not aggregation. This is because the rental real estate enterprise is not yet deemed to be a trade or business until after the 250-hour safe harbor requirement is met.

In other words, the aggregation disclosure rules apply if two or more real estate enterprises are aggregated by the passthrough entity.

Practice Pointer

We have received many questions from tax professionals whose clients receive a K-1 from a passthrough entity engaged in rental real estate activities and want to know how they can tell if the passthrough entity applied the rental real estate safe harbor rules.

The answer is that you can't tell because it doesn't matter. The sole purpose of the safe harbor is to determine whether rental properties are a trade or business and therefore whether their income is qualified business income.

If the tax professional that prepares the passthrough entity's income tax return determines that rental properties are trades or businesses, then they will report the requisite IRC §199A information on the K-1 (QBI, W-2 wages, UBIA). It does not matter to the recipient of the K-1 whether that determination was made using the safe harbor or based on facts and circumstances.

If you receive a K-1 from a passthrough entity engaged in real estate activities and there is no IRC §199A information reported (QBI, W-2 wages, UBIA), then the passthrough entity has made the determination that the real estate activity is not a trade or business.

MISCELLANEOUS ISSUES

ELECTION TO AVOID PARTNERSHIP TAX TREATMENT

A partnership, for income tax reporting purposes, includes a syndicate, group, pool, or joint venture. (IRC §761) However, if all the members of an unincorporated association so elect, they may exclude the organization from partnership treatment and report all income and make all applicable elections on the individual partners' returns.

Example of separate depreciation elections under IRC §761(a) election

Emma and Olivia pooled their money to purchase a rental property in 2021. They each contributed \$200,000, and they agreed to hold title as tenants-in-common and split the income and expenses from the property 50/50.

Emma and Olivia make a valid IRC §761(a) election, so they each report 50% of the rental income and expenses on Schedule E of their respective returns.

In 2023, Emma and Olivia install new appliances in the rental property at a cost of

\$10,000. Because the IRC §761(a) election allows each owner to make their own elections, Emma can avail herself of bonus depreciation for her share of the cost of the appliances, and Olivia can elect out of bonus depreciation.

The bonus depreciation rate is 80% through December 31, 2023.

To qualify, the unincorporated association must be created:

- For investment purposes only and not for the active conduct of a trade or business (often referred to as an investing partnership);
- For the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted; or
- By dealers in securities for a short period for the limited purpose of underwriting, selling, or distributing a particular issue of securities.

Additionally, each member of the organization must be able to adequately determine their income without the computation of partnership taxable income. (IRC §761(a)) For this reason, the IRC §761 election is most commonly used for real estate investments.

6[™] Caution

A strict interpretation of the Internal Revenue Code seems to permit an IRC §761(a) election for any partnership (including LPs, LLPs, and LLCs). However, if state law in the state where the partnership or LLC was organized treats the entity as the owner of the property instead of treating each member or partner as co-owners, then an IRC §761(a) election may not be available.

This issue was addressed in a 2002 IRS Field Service Advice Memorandum 200216005 (regarding limited partnerships) and again in 2004 in Revenue Ruling 2004-33 (regarding a Delaware statutory trust (DST)), but the issue has not otherwise been addressed or tested by the IRS or the courts.

This is not an issue for general partnerships because they are not "organized" under state law.

Comment

Unincorporated associations participating in active trades or businesses do not qualify for an IRC §761(a) election.

Making the IRC §761(a) election

The qualifying syndicate, pool, joint venture, or similar organization must make an election under IRC §761(a) on a timely filed partnership income tax return. Form 1065, U.S. Return of Partnership Income, is required only for the year of the election.

The election is made by attaching a statement to Form 1065. The Form 1065 must contain only the following information:

- The name or other identification and the address of the organization;
- The names, addresses, and identification numbers of all the members of the organization;
- A statement that the organization qualifies under Treas. Regs. §1.761-2(a)(1) and either (2) or (3) (relating to whether the organization is an investing partnership and the rights of the members);
- A statement that all of the members of the organization elect that the organization be excluded from all of subchapter K; and
- A statement indicating where a copy of the agreement under which the organization operates is available (or if the agreement is oral, from whom the provisions of the agreement may be obtained). (Treas. Regs. §1.761-2(b)(2)(i))

Relief available where IRC §761(a) election is not made

If a qualifying syndicate, pool, joint venture, or similar organization fails to make an IRC §761(a) election, it will nevertheless be deemed to have made the election if it can be shown from all the surrounding facts and circumstances that it was the intention of the members of the organization at the time of its formation to secure exclusion from all of subchapter K beginning with the first taxable year of the organization. (Treas. Regs. §1.761-2(b)(ii))

Example of failure to make IRC §761(a) election

Roger and Jessica pooled their money to purchase a rental property in 2024. Roger contributed \$250,000 and Jessica contributed \$750,000 toward the purchase price of the property. They orally agreed to hold title as tenants-in-common and split the income and expenses from the property based on their initial contribution (25% Roger and 75% Jessica).

Roger and Jessica did not file Form 1065 in 2024, but they have each reported their share of the rental property's income and expenses on their respective Schedules E each year.

Roger and Jessica are deemed to have made the IRC §761(a) election because it can be shown from all the surrounding facts and circumstances (their oral agreement and their tax reporting history) that it was their intention from the outset to exclude their investment venture from subchapter K.

IDLE PROPERTY

Subject to the passive activity rules discussed above, taxpayers may continue to deduct their rental expenses necessary to manage and maintain the property when a rental house is vacant. This applies to "idle" periods such as:

- The period prior to the time the property owner begins to rent the property;
- Between tenants; or
- While the property owner is trying to sell the property.

In *Bonds v. Comm.* (TCS 2011-122), the taxpayer moved from Kansas City to Minnesota in 1988. From that time through 2005, she was able to rent out her former principal residence in Kansas City. In 2006 and 2007, the property was available for rent but was not rented due to various factors including a weak local economy and the property's location. The taxpayer continued to hold the property because she believed she could still sell it for a profit, but it

was never actually put up for sale. The taxpayer did not use the property for personal purposes after her move to Minnesota. On her 2006 and 2007 returns, the taxpayer claimed Schedule E rental losses from expenses including mortgage interest, property taxes, depreciation, cleaning and maintenance, utilities, insurance, advertising, and auto travel to visit the property. There was no rental income in either year.

The Tax Court held that the taxpayer was entitled to deduct rental losses for 2006 and 2007, even though the property was not rented in those years, noting that holding property for the production of income can include income expected in future years, including an anticipated gain on sale. In 2006 and 2007, the taxpayer had reason to believe she could sell the property for a gain. The court also rejected the IRS's position that the taxpayer's rental losses were suspended by the passive activity loss (PAL) rules since she met the active participation requirement to currently deduct up to \$25,000 of annual PALs from rental real estate.

GROUP STUDY MATERIALS

A. Discussion Questions

- 1. How can a taxpayer demonstrate material participation in their rental activities beyond the 500-hour test?
- 2. What are the tax implications of making a single-activity election for rental properties under IRC §469(c)(7)(A)?
- 3. Why do many full-time employees in non-real estate fields fail to meet the real estate professional status tests?
- 4. How does the use of a property management company affect a taxpayer's ability to qualify as a real estate professional?
- 5. How does Revenue Procedure 2019-38 help taxpayers in determining whether their rental real estate qualifies as a trade or business for the IRC §199A deduction?
- 6. Why are triple net leases excluded from the rental real estate safe harbor, and what implications does this have for property owners?

B. Suggested Answers to Discussion Questions

- 1. A taxpayer can demonstrate material participation by meeting any of the seven tests outlined by the IRS, such as performing substantially all the work in the activity, working more than 100 hours and more than anyone else, or materially participating in the activity for at least 5 of the last 10 years.
- 2. By making a single-activity election, a taxpayer treats all their rental real estate activities as one, simplifying the ability to meet the material participation requirements and potentially allowing larger deductions. However, previously suspended losses may still be suspended if the taxpayer sells only one property within the group.
- 3. A full-time employee typically works around 2,000 hours per year. Since the first test requires that more than half of the taxpayer's personal services must be spent in real property trades or businesses, the taxpayer would need to spend more than 2,000 hours (i.e., at least 2,001 hours) on their real estate activities to pass the "50% test."

This is very difficult because there are only 8,760 hours in a year, and most full-time workers already devote a significant portion of their time to their primary jobs, leaving little time for real estate activities. To meet this threshold, the taxpayer would essentially need to double the number of hours they work, which is often impractical.

- 4. Using a property management company typically reduces the taxpayer's direct involvement in the property, making it more difficult to meet the 750-hour requirement and the material participation tests necessary for real estate professional status. The IRS does not count hours spent supervising contractors or reviewing the property management company's work as personal services. Therefore, taxpayers who delegate most of their responsibilities to management companies often fail to qualify for the real estate professional status or materially participate in their rental activities.
- 5. Although rental real estate can rise to the level of a Code Sec. 162 trade or business for IRC §199A purposes, Revenue Procedure 2019-38 provides a clear safe harbor. When the safe harbor requirements are met, taxpayers can ensure their rental income qualifies for the qualified business income deduction.
- 6. Triple net leases are excluded from the safe harbor because in such leases, the tenant, rather than the property owner, bears the responsibility for property taxes, insurance, and maintenance. This reduces the owner's involvement in managing the property, which contrasts with the level of direct participation the safe harbor aims to ensure. As a result, property owners with triple net leases must demonstrate that their activities meet the trade or business standard without relying on the safe harbor.

46 October 2024

GLOSSARY OF KEY TERMS

AFS—Applicable Financial Statement

AML—Anti-Money Laundering

BSA—Bank Secrecy Act

CFT—Countering the Financing of Terrorism

ERA—Exempt Reporting Adviser

FBAR—Foreign Bank Account Records

FinCEN—Financial Crimes Enforcement Network

IRA—Inflation Reduction Act of 2022

NTA—National Taxpayer Advocate

NIIT—Net Investment Income Tax

Publication 946—How to Depreciate Property

QBI—Qualified Business Income

RIA—Registered Investment Adviser

SEC—U.S. Securities and Exchange Commission

TIGTA—Treasury Inspector General for Tax Administration

TPR—Tangible Property Repair

UBIA—Unadjusted Basis Immediately after Acquisition

Tax Report

Volume 37, Issue 9 October 2024

Choose the best response and record your answer in the space provided on the answer sheet.

- 1. According to Ian Redpath, which doctrine can the IRS invoke to challenge basis-shifting transactions?
 - A. Doctrine of constructive receipt
 - B. Economic substance doctrine
 - C. Substance over form doctrine
 - D. Doctrine of anticipatory assignment of income
- 2. According to Ian Redpath, which of the following is **not** one of the key basis-shifting transactions identified by the IRS?
 - A. High-basis property to a low-basis taxpayer
 - B. Low-basis property distributed in liquidation
 - C. Transfers of partnership interests between unrelated parties
 - D. Transfers of partnership interests between related parties
- 3. According to Ian Redpath, which term describes transactions the IRS believes may be abusive but lacks enough information to classify definitively as abusive?
 - A. Listed transactions
 - B. Transactions of interest
 - C. Reportable transactions
 - D. Economic substance transactions
- 4. According to Ian Redpath, what standard did the court use in *U.S. v. Hughes* to determine willfulness in failing to file FBARs?
 - A. Actual intent only
 - B. Deliberate fraud
 - C. Simple negligence
 - D. Objective recklessness
- 5. According to Ian Redpath, how does the second Employee Retention Credit (ERC) voluntary disclosure program differ from the first?
 - A. It offers a higher discount than the original program.
 - B. It eliminates all penalties for improper claims.
 - C. It provides a 5% lower discount compared to the previous program.
 - D. It is only available for new ERC claims submitted after 2024.

Continued on next page

CPE Network® Tax Report Quizzer

6. According to Ian Redpath, what should a taxpayer do if they receive a disallowance letter from the IRS concerning their Employee Retention Credit (ERC) claim and they want to appeal the decision?

- A. Wait for the Independent Office of Appeals to automatically review the claim
- B. File a lawsuit in Tax Court immediately
- C. Submit a protest to the IRS
- D. Refile the ERC claim with the same documentation to get it reviewed again
- 7. According to Renée Rodda, what is one of the two tests that must be met to qualify as a real estate professional?
 - A. The taxpayer must perform more than half of their personal services in real property trades or businesses.
 - B. The taxpayer must own at least 5% of the business.
 - C. The taxpayer must have a spouse who also works in the business.
 - D. The taxpayer must file a joint return.
- 8. According to Renée Rodda, what is the required minimum number of personal service hours a taxpayer must spend in real property trades or businesses to qualify as a real estate professional?
 - A. 500 hours
 - B. 750 hours
 - C. 1000 hours
 - D. 2000 hours
- 9. According to Renée Rodda, can hours worked by both spouses be combined to meet the real estate professional tests?
 - A. Yes, if the spouses file jointly
 - B. Yes, when both spouses are 5% owners in the business
 - C. Yes, when one spouse performs more than half of the work
 - D. No, hours cannot be combined
- 10. According to Renée Rodda, what is the result when a taxpayer qualifies as a real estate professional but fails to elect to group rental activities as a single activity?
 - A. Each rental property is treated as a separate activity for material participation purposes.
 - B. The taxpayer can deduct all rental losses without limitation.
 - C. The taxpayer is automatically considered to have materially participated in each activity.
 - D. All rental properties are treated as passive activities.

Continued on next page

11. According to Renée Rodda, under what circumstances can previously suspended losses from a rental property be released?

- A. When the property is sold as part of a like-kind exchange
- B. When the taxpayer qualifies as a real estate professional
- C. When all grouped properties in a single activity are sold
- D. When the property generates a net operating income
- 12. According to Renée Rodda, how many years must a taxpayer materially participate in an activity within the last 10 years to meet the prior years' material participation test?
 - A. 3 years
 - B. 5 years
 - C. 7 years
 - D. 10 years
- 13. According to Renée Rodda, what is the purpose of the rental real estate safe harbor rule under Revenue Procedure 2019-38?
 - A. To determine whether rental real estate qualifies as a trade or business for IRC §199A purposes
 - B. To assess the tax treatment of suspended losses
 - C. To simplify compliance with record-keeping requirements for rental real estate
 - D. To determine whether rental activities are passive or nonpassive
- 14. How many hours of rental services are required to qualify for the rental real estate safe harbor under IRC §199A?
 - A. At least 200 hours of rental services performed annually
 - B. 250 or more hours of rental services performed annually
 - C. At least 500 hours of rental services performed annually
 - D. 500 or more hours of rental services performed annually
- 15. According to Renée Rodda, how does a taxpayer report properties that are grouped into a rental real estate enterprise for IRC §199A safe harbor purposes?
 - A. Include the properties on Form 8825
 - B. Consolidate all income and expenses for properties in a single statement
 - C. Report all properties as a single line item on Schedule E
 - D. Report each property separately on Schedule E

50 October 2024

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SUBSCRIBER SURVEY Evaluation Form

Please take a few minutes to complete this survey related to the **CPE Network® Tax Report** and return with your quizzer or group attendance sheet to CeriFi, LLC. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to **CPLgrading@cerifi.com**.

How would you rate the topics covered in the October 2024 **CPE Network® Tax Report**? Rate each topic on a scale of 1–5 (5=highest):

Experts' Forum Key Considerations of Taxing Rental Real Estate: Part 2	Topic Relevance	Topic Content/ Coverage	Topic Timeliness	Video Quality	Audio Quality	Written Material
Which segments of the October 2024 issue of CPE Net	work [®] Ta	ax Report	t did you li	ke the mo	ost, and w	hy?
Which segments of the October 2024 issue of CPE Net	work® Ta	ax Report	t did you li	ke the lea	st, and w	hy?
What would you like to see included or changed in future	re issues o	of CPE N	etwork [®] T	ax Repo	r t ?	
Are there any other ways in which we can improve CPF	E Networ	k [®] Tax R	eport?			

How would you rate the effectiveness of the spea scale of 1–5 (5=highest):	eakers in the	e October 2024	4 CPE Network® Tax Ro	eport? Rate each speaker on
	Overall	Knowledge of Topic	Presentation Skills	
Ian Redpath				
Renee Rodda				
Which of the following would you use for view	ving CPE No	etwork® Tax	Report? DVD Stream	ing □ Both □
Are you using CPE Network® Tax Report for	:	CPE Cr	edit Information	Both \Box
Were the stated learning objectives met? Yes	No □			
If applicable, were prerequisite requirements ap	ppropriate? Y	Yes 🗆 No 🗆		
Were program materials accurate? Yes □	No □			
Were program materials relevant and contribute	e to the achie	evement of the	e learning objectives?	Yes \square No \square
Were the time allocations for the program appro	opriate? Ye	s 🗆 No 🗆		
Were the supplemental reading materials satisfa	actory? Ye	s 🗆 No 🗆		
Were the discussion questions and answers sati	•	Yes 🗆	No □	
Were the audio and visual materials effective?		s 🗆 No 🗆		
Specific Comments:				
Name/Company				
Address				
City/State/Zip				

Once Again, Thank You... Your Input Can Have a Direct Influence on Future Issues!

CPE Network® CPE Group Attendance Sheet

Firm/Company Name:					
Account #:					
Location:					
Program Title:					Date:
Name	<u>Email</u>	Total Hrs	IRS PTIN ID (if applicable Tax only)	Sign In	Sign Out
I certify that the above individuals viewed and were participants in the group discussion with this issue/segment of the CPE Network [®] newsletter, and earned the number of hours shown.	wed and were participants in	the group	discussion with this issue/segmen	t of the CPE Netw	ork $^{\scriptscriptstyle{ ext{@}}}$ newsletter, and earned
Instructor Name:			Date:		
E-mail address:					
License State and Number:			ĺ		

CPE Network/Webinar Delivery Tracking Report

Course Title	
Course Date:	
Start Time:	
End Time:	
Moderator Name, Credentials, and Signature Attestation of Attendance:	
Delivery Method:	Group Internet Based
Total CPE Credit:	3.0
Instructions:	During the webinar, the moderator must verify student presence a minimum of 3 times per CPE hour. This is achieved via polling questions. Sponsors must have a report which documents the responses from each student. The timing of the polling questions should be random and not made known to students prior to delivery of the course. Record the polling question responses below. Refer to the CPL Network User Guide for more instructions. Partial credit will not be issued for students who do not respond to at least 3 polling questions per CPE hour.
Brief Description of Method of Polling	Example: Zoom: During this webinar, moderator asked students to raise their hands 3 times per CPE hour. The instructor then noted the hands that were raised in the columns below.

			Fire	st CPE H	lour	C	PE Houi	2	C	PE Houi	· 3	FOR TR USE ONLY
First Name	Last Name	Student Email	Poll 1	Poll 2	Poll 3	Poll 1	Poll 2	Poll 3	Poll 1	Poll 2	Poll 3	Certificate Issued?
							1					

CHECKPOINT LEARNING NETWORK

CPE NETWORK® USER GUIDE

REVISED December 31, 2023

Welcome to CPE Network!

CPE Network programs enable you to deliver training programs to those in your firm in a manageable way. You can choose how you want to deliver the training in a way that suits your firm's needs: in the classroom, virtual, or self-study. You must review and understand the requirements of each of these delivery methods before conducting your training to ensure you meet (and document) all the requirements.

This User Guide has the following sections:

- "Group Live" Format: The instructor and all the participants are gathered into a common area, such as a conference room or training room at a location of your choice.
- "Group Internet Based" Format: Deliver your training over the internet via Zoom, Teams, Webex, or other application that allows the instructor to present materials that all the participants can view at the same time.
- "Self-Study" Format: Each participant can take the self-study version of the CPE Network program on their own computers at a time and place of their convenience. No instructor is required for self-study.
- Transitioning From DVDs: For groups playing the video from the online platform, we suggest downloading the video from the Checkpoint Learning player to the desktop before projecting.
- What Does It Mean to Be a CPE Sponsor?: Should you decide to vary from any of the requirements in the 3 methods noted above (for example, provide less than 3 full CPE credits, alter subject areas, offer hybrid or variations to the methods described above), Checkpoint Learning Network will not be the sponsor and will not issue certificates. In this scenario, your firm will become the sponsor and must issue its own certificates of completion. This section outlines the sponsor's responsibilities that you must adhere to if you choose not to follow the requirements for the delivery methods.
- **Getting Help:** Refer to this section to get your questions answered.

IMPORTANT: This User Guide outlines in detail what is required for each of the 3 formats above. Additionally, because you will be delivering the training within your firm, you should review the Sponsor Responsibilities section as well. To get certificates of completion for your participants following your training, you must submit all the required documentation. (This is noted at the end of each section.) Checkpoint Learning Network will review your training documentation for completeness and adherence to all requirements. If all your materials are received and complete, certificates of completion will be issued for the participants attending your training. Failure to submit the required completed documentation will result in delays and/or denial of certificates.

IMPORTANT: If you vary from the instructions noted above, your firm will become the sponsor of the training event and you will have to create your own certificates of completions for your participants. In this case, you do not need to submit any documentation back to CeriFi, LLC.

If you have any questions on this documentation or requirements, refer to the "Getting Help" section at the end of this User Guide **BEFORE** you conduct your training.

We are happy that you chose CPE Network for your training solutions. Thank you for your business and HAPPY LEARNING!

Copyrighted Materials

CPE Network program materials are copyrighted and may not be reproduced in another document or manuscript in any form without the permission of the publisher. As a subscriber of the **CPE Network Series,** you may reproduce the necessary number of participant manuals needed to conduct your group study session.

"Group Live" Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

*Effective November 1, 2018: Checkpoint Learning CPE Network products 'group live' sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for "group live" deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the "group live" session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template after the executive summary of the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance

You must monitor individual participant attendance at "group live" programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient.

Use the **attendance sheet.** This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a "no show," the actual hours they attended should be documented on the sign-in sheet and will be reflected on the participant's CPE certificate.

Real Time Instructor During Program Presentation

"Group live" programs must have a **qualified**, **real time instructor while the program is being presented**. Program participants must be able to interact with the instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A "group live" program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Make-Up Sessions

Individuals who are unable to attend the group study session may use the program materials for self-study online.

- If the emailed materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the email address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his/their CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded by Checkpoint Learning Network after the "group live" documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the "group live" session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the "group live" session, it is required that the firm hosting the "group live" session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Group Study Attendance sheets; indicating any late arrivals and/or early departures)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations.

Finding the Transcript

Note: DVDs no longer ship with this product effective 3/1/2023.

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

https://get.adobe.com/reader/

The entire transcript is also available as a pdf in the Checkpoint Learning player in the resource toolbox at the top of the screen, or via the link in the email sent to administrators.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your "group live" session should be sent to Checkpoint Learning Network by the following means:

Email: CPLgrading@cerifi.com

When sending your package to CeriFi, you must include ALL of the following items:

Form Name	Included?	Notes
Advertising /		Complete this form and circulate to your audience
Promotional Page		before the training event.
Attendance Sheet		Use this form to track attendance during your training
		session.
Subscriber Survey		Circulate the evaluation form at the end of your
Evaluation Form		training session so that participants can review and
		comment on the training. Return to CeriFi any
		evaluations that were completed. You do not have to
		return an evaluation for every participant.

Incomplete submissions will be returned to you.

"Group Internet Based" Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

*Effective November 1, 2018: Checkpoint Learning CPE Network products 'group live' sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for "group live" deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the "group live" session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template following the executive summary in the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance in a Webinar

You must monitor individual participant attendance at "group internet based" programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient.

Use the **Webinar Delivery Tracking Report.** This form lists the moderator(s) name and credentials, as well as the first and last name of each participant attending the seminar. During a webinar you must set up a monitoring mechanism (or polling mechanism) to periodically check the participants' engagement throughout the delivery of the program. Participants' two-way video should remain on during the entire presentation.

In order for CPE credit to be granted, you must confirm the presence of each participant **3 times per CPE hour and the participant must reply to the polling question**. Participants that respond to less than 3 polling questions in a CPE hour will not be granted CPE credit. For example, if a participant only replies to 2 of the 3 polling questions in the first CPE hour, credit for the first CPE hour will not be granted. (Refer to the Webinar Delivery Tracking Report for examples.)

Examples of polling questions:

1. You are using **Zoom** for your webinar. The moderator pauses approximately every 15 minutes and asks that participants confirm their attendance by using the "raise hands"

- feature. Once the participants raise their hands, the moderator records the participants who have their hands up in the **webinar delivery tracking report** by putting a YES in the webinar delivery tracking report. After documenting in the spreadsheet, the instructor (or moderator) drops everyone's hands and continues the training.
- 2. You are using **Teams** for your webinar. The moderator will pause approximately every 15 minutes and ask that participants confirm their attendance by typing "Present" into the Teams chat box. The moderator records the participants who have entered "Present" into the chat box into the **webinar delivery tracking report**. After documenting in the spreadsheet, the instructor (or moderator) continues the training.
- 3. If you are using an application that has a way to automatically send out polling questions to the participants, you can use that application/mechanism. However, following the event, you should create a **webinar delivery tracking report** from your app's report.

Additional Notes on Monitoring Mechanisms:

- 1. The monitoring mechanism does not have to be "content specific." Rather, the intention is to ensure that the remote participants are present and paying attention to the training.
- You should only give a minute or so for each participant to reply to the prompt. If, after a minute, a participant does not reply to the prompt, you should put a NO in the webinar delivery tracking report.
- 3. While this process may seem unwieldy at first, it is a required element that sponsors must adhere to. And after some practice, it should not cause any significant disruption to the training session.
- 4. You must include the Webinar Delivery Tracking report with your course submission if you are requesting certificates of completion for a "group internet based" delivery format.

Real Time Moderator During Program Presentation

"Group internet based" programs must have a **qualified**, **real time moderator while the program is being presented**. Program participants must be able to interact with the moderator while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

Where individual participants log into a group live program they are required to enable two-way video to participate in a virtual face-to-face setting (with cameras on), elements of engagement are required (such as group discussion, polling questions, instructor posed questions with time for reflection, or a case study with engagement throughout the presentation) in order to award CPE credits to the participants. Participation in the two-way video conference must be monitored and documented by the instructor or attendance monitor in order to authenticate attendance for program duration. The participant-to-attendance

monitor ratio must not exceed 25:1, unless there is a dedicated attendance monitor in which case the participant-to-attendance monitor ratio must not exceed 100:1.

Make-Up Sessions

Individuals who are unable to attend the "group internet based" session may use the program materials for self-study either in print or online.

- If emailed materials are used, the user should read the materials, watch the
 video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send
 the answer sheet and course evaluation to the email address listed on the
 answer sheet and the CPE certificate will be mailed or emailed to the user.
 Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual
 Checkpoint Learning account to read the materials, watch the interviews, and
 answer the quizzer questions. The user will be able to print her/his CPE
 certificate upon completion of the quizzer. (If you need help setting up individual
 user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded by Checkpoint Learning Network after the "group internet based" documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who may not have answered the required amount of polling questions.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the "group live" session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the "group internet based" session, it is required that the firm hosting the session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Webinar Delivery Tracking Report)
- Copy of the program materials
- Timed agenda with topics covered
- Date and location (which would be "virtual") of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations

Finding the Transcript

Note: DVDs are no longer shipped effective 3/1/2023

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. It should look something like the screenshot below. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

https://get.adobe.com/reader/

Alternatively, for those without a DVD drive, the email sent to administrators each month has a link to the pdf for the newsletter. The email may be forwarded to participants who may download the materials or print them as needed.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your "group internet based" session should be sent to Checkpoint Learning Network by the following means:

Email: CPLgrading@CeriFi.com

When sending your package to CeriFi, you must include ALL the following items:

Form Name	Included?	Notes
Advertising /		Complete this form and circulate to your audience
Promotional Page		before the training event.
Webinar Delivery		Use this form to track the attendance (i.e., polling
Tracking Report		questions) during your training webinar.
Evaluation Form		Circulate the evaluation form at the end of your
		training session so that participants can review and
		comment on the training. Return to CeriFi any
		evaluations that were completed. You do not have to
		return an evaluation for every participant.

Incomplete submissions will be returned to you.

"Self-Study" Format

If you are unable to attend the live group study session, we offer two options for you to complete your Network Report program.

Self-Study—Email

Follow these simple steps to use the printed transcript and video:

- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
- E-mail your completed quizzer and survey to:

CPLgrading@cerifi.com

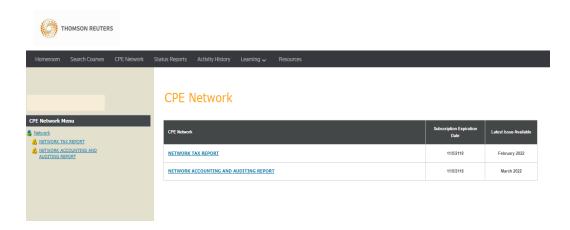
Self-Study-Online

Follow these simple steps to use the online program:

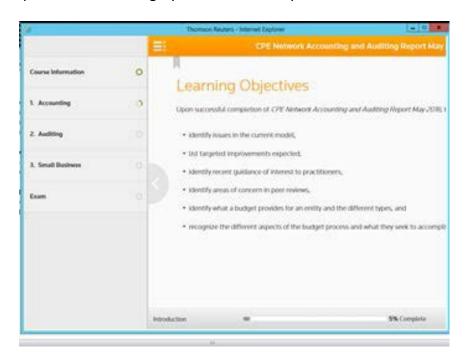
- Go to www.checkpointlearning.thomsonreuters.com.
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login or Register").



• In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.

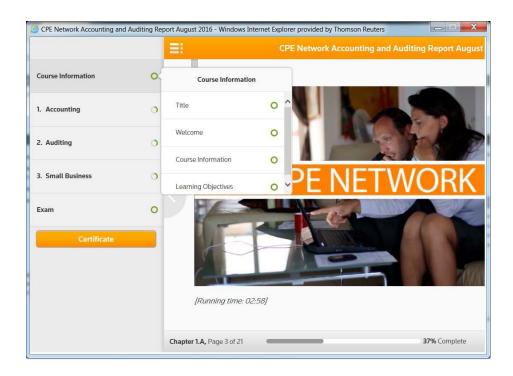


The Chapter Menu is in the gray bar at the left of your screen:



Click down to access the dropdown menu and move between the program Chapters.

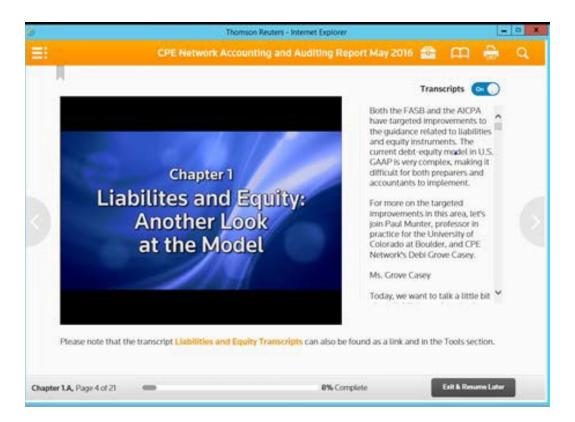
• **Course Information** is the course Overview, including information about the authors and the program learning objectives



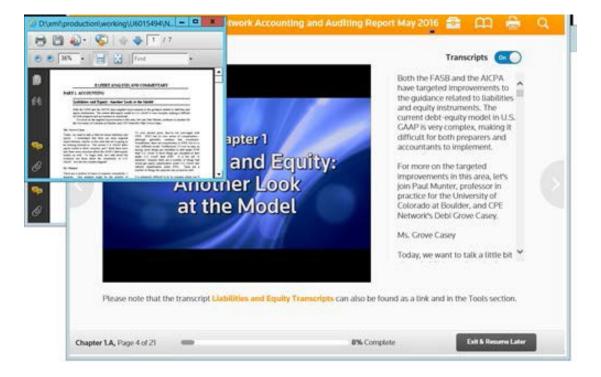
• Each Chapter is self-contained. Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This streamlined approach allows administrators and users to more easily access the related materials.



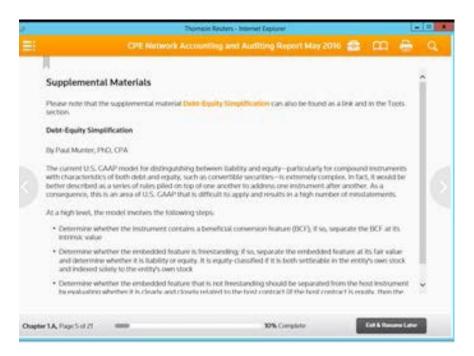
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.

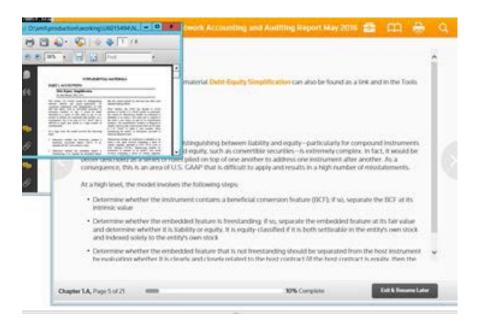


Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts** or via the link to the pdf below the video (also available in the toolbox in the resources section). The pdf will appear in a separate pop-up window.



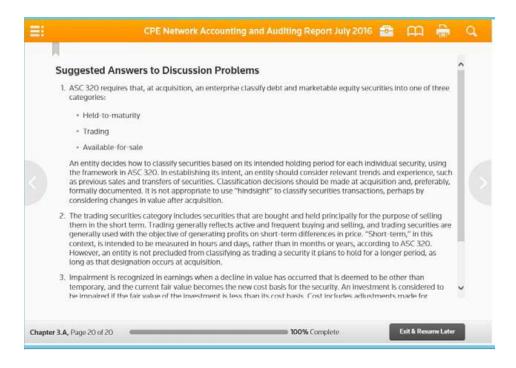
Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.





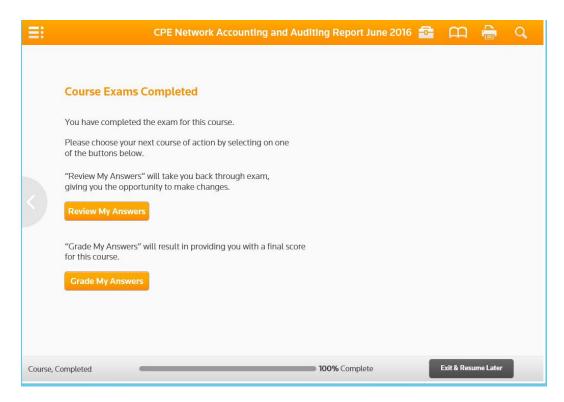
Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

The Suggested Answers to the Discussion Problems follow the Discussion Problems.



The **Exam** is accessed by clicking the last gray bar on the menu at the left of the screen or clicking through to it. Click the orange button to begin.

When you have completed the quizzer, click the button labeled **Grade or the Review button**.



- Click the button labeled Certificate to print your CPE certificate.
- The final quizzer grade is displayed and you may view the graded answers by clicking the button labeled view graded answer.

Additional Features Search

Checkpoint Learning offers powerful search options. Click the **magnifying glass** at the upper right of the screen to begin your search. Enter your choice in the **Search For:** box.

Search Results are displayed with the number of hits.

Print

To display the print menu, click the printer icon in the upper bar of your screen. You can print the entire course, the transcript, the glossary, all resources, or selected portions of the course. Click your choice and click the orange **Print**.

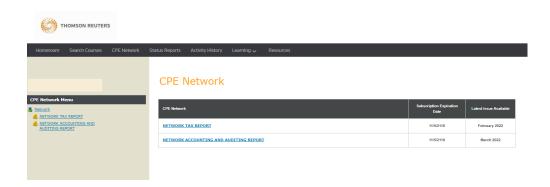
Transitioning From DVDs

Follow these simple steps to access the video and pdf for download from the online platform:

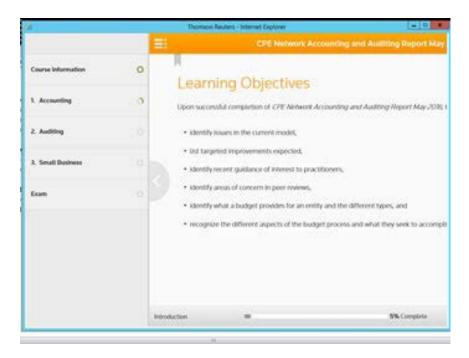
- Go to <u>www.checkpointlearning.thomsonreuters.com</u>.
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



• In the CPE **Network** tab, select the desired Network Report by clicking on the title, then select the appropriate edition.

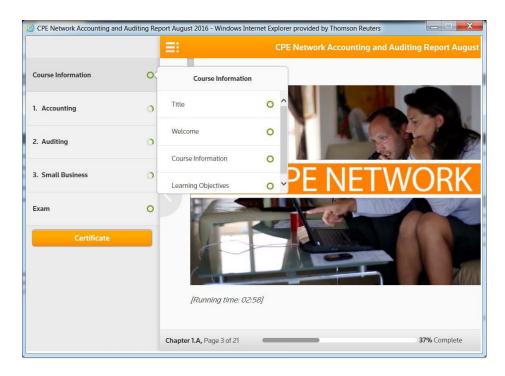


The Chapter Menu is in the gray bar at the left of your screen:



Click down to access the dropdown menu and move between the program Chapters.

• **Course Information** is the course Overview, including information about the authors and the program learning objectives



• Each Chapter is self-contained. Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions.



Video segments may be downloaded from the CPL player by clicking on the download button noted above. You may need to use the scroll bar to the right of the video to see the download button. Tip: You may need to use the scroll bar to the right of the video to see the download button.

PDFs may be downloaded from either the course toolbox in the upper right corner of the Checkpoint Learning screen or from the email sent to administrators with each release.

What Does It Mean to Be a CPE Sponsor?

If your organization chooses to vary from the instructions outlined in this User Guide, your firm will become the CPE Sponsor for this monthly series. The sponsor rules and requirements noted below are only highlights and reflect those of NASBA, the national body that sets guidance for development, presentation, and documentation for CPE programs. For any specific questions about state sponsor requirements, please contact your state board. They are the final authority regarding CPE Sponsor requirements. Generally, the following responsibilities are required of the sponsor:

- Arrange for a location for the presentation
- Advertise the course to your anticipated participants and disclose significant features of the program in advance
- Set the start time
- Establish participant sign-in procedures
- Coordinate audio-visual requirements with the facilitator
- Arrange appropriate breaks
- Have a real-time instructor during program presentation
- Ensure that the instructor delivers and documents elements of engagement
- Monitor participant attendance (make notations of late arrivals, early departures, and "no shows")
- Solicit course evaluations from participants
- Award CPE credit and issue certificates of completion
- Retain records for five years

The following information includes instructions and generic forms to assist you in fulfilling your responsibilities as program sponsor.

CPE Sponsor Requirements

Determining CPE Credit Increments

Sponsored seminars are measured by program length, with one 50-minute period equal to one CPE credit. One-half CPE credit increments (equal to 25 minutes) are permitted after the first credit has been earned. Sponsors must monitor the program length and the participants' attendance in order to award the appropriate number of CPE credits.

Program Presentation

CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. CPE program sponsors must make the following information available in advance:

- Learning objectives.
- Instructional delivery methods.
- Recommended CPE credit and recommended field of study.
- Prerequisites.
- Program level.
- Advance preparation.
- Program description.
- Course registration and, where applicable, attendance requirements.
- Refund policy for courses sold for a fee/cancellation policy.
- Complaint resolution policy.
- Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPE credits).

Disclose Significant Features of Program in Advance

For potential participants to effectively plan their CPE, the program sponsor must disclose the significant features of the program in advance (e.g., through the use of brochures, website, electronic notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with non-educational activities, or when several CPE programs are offered concurrently, participants must receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration and attendance policies and procedures must be formalized, published, and made available to participants and include refund/cancellation policies as well as complaint resolution policies.

Monitor Attendance

While it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must maintain a process to monitor individual attendance at group programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient. The sign-in sheet should list the names of each instructor and her/his credentials, as well as the name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant leaves early, the hours they attended should be documented on the sign-in sheet and on the participant's CPE certificate.

Real Time Instructor During Program Presentation

"Group live" programs must have a qualified, real-time instructor while the program is being presented. Program participants must be able to interact with the real time instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A "group live" program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded at the conclusion of the seminar. It should reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

CFP credit is available if the firm registers with the CFP board as a sponsor and meets the CFP board requirements. IRS credit is available only if the firm registers with the IRS as a sponsor and satisfies their requirements.

Seminar Quality Evaluations for Firm Sponsor

NASBA requires the seminar to include a means for evaluating quality. At the seminar conclusion, evaluations should be solicited from participants and retained by the sponsor for five years. The following statements are required on the evaluation and are used to determine whether:

- 1. Stated learning objectives were met.
- 2. Prerequisite requirements were appropriate (if any).
- 3. Program materials were accurate.
- 4. Program materials were relevant and contributed to the achievement of the learning objectives.
- 5. Time allotted to the learning activity was appropriate.
- 6. Individual instructors were effective.
- 7. Facilities and/or technological equipment were appropriate.
- 8. Handout or advance preparation materials were satisfactory.
- 9. Audio and video materials were effective.

You may use the enclosed preprinted evaluation forms for your convenience.

Retention of Records

The seminar sponsor is required to retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (the original sign-in sheets, now in an editable, electronic signable format)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name(s) and credentials
- Results of program evaluations

Appendix: Forms

Here are the forms noted above and how to get access to them.

Delivery Method	Form Name	Location	Notes
"Group Live" /	Advertising /	Transcript	Complete this form and
"Group Internet	Promotional Page		circulate to your audience
Based"			before the training event.
"Group Live"	Attendance Sheet	Transcript	Use this form to track
			attendance during your
			training session.
"Group Internet	Webinar Delivery	Transcript	Use this form to track the
Based"	Tracking Report		'polling questions' which
			are required to monitor
			attendance during your
			webinar.
"Group Live" /	Evaluation Form	Transcript	Circulate the evaluation
"Group Internet			form at the end of your
Based"			training session so that
			participants can review
			and comment on the
			training.
Self Study	CPE Quizzer Answer	Transcript	Use this form to record
	Sheet		your answers to the quiz.

Getting Help

Should you need support or assistance with your account, please see below:

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	844.245.5970	Cplsupport@cerifi.com	 Browser-based Certificate discrepancies Accessing courses Migration questions Feed issues
Product Support	844.245.5970	Cplsupport@cerifi.com	 Functionality (how to use, where to find) Content questions Login Assistance
Customer Support	844.245.5970	Cplsupport@cerifi.com	 Billing Existing orders Cancellations Webinars Certificates