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## Course Information

**Course Title:** *Passive Losses #492823*

**Recommended CPE credit hours for this course**

In accordance with the standards of the National Registry of CPE Sponsors and the IRS, CPE credits have been granted based on a 50-minute hour.

**CPA 10.5** (All states)

National Registry of CPE Sponsors ID Number: 107615.

Sponsor numbers for states requiring sponsor registration:

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Hawaii Board of Public Accountancy: 14003

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Ohio State Board of Accountancy: M0021

Pennsylvania Board of Accountancy: PX 178025

Texas State Board of Accountancy: 009349

**EA/OTRP 10** (All States) IRS: Qualified Sponsor number: *FWKKO*.

**Course Description**

This course addresses the practical aspects of §469 and the needed skill to handle pragmatic issues. Fundamentals are reviewed, planning opportunities identified, and creative strategies discussed and evaluated along with remaining traditional approaches. The goal of this instructive program is to understand and solve problems under §469, with an emphasis on tax savings ideas. Readers will overview the proper administration of this complex and often cumbersome provision.

**Course Content**

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Author: Danny Santucci, J.D.

Final exam (online): Eighty questions (multiple-choice).

**Program Delivery Method:** Self-Study (NASBA QAS Self-Study/interactive)

## Subject Codes/Field of Study

NASBA (CPA): Taxes.

IRS (EA, OTRP): Federal Tax Law.

## Course Level, Prerequisites, and Advance Preparation Requirements

Program Level: NASBA/CPA, IRS: Overview.

This program is appropriate for professionals at all organizational levels.

Prerequisites: Basic familiarity with federal taxation

Advance Preparation: None

### Instructions for Taking This Course

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# Learning Assignments & Objectives

(Table of Contents follows the Learning Objectives.)

As a result of studying each assignment, you should be able to meet the objectives listed below each assignment.

ASSIGNMENT	SUBJECT
<b>Chapter 1</b>	<b>Overview</b>

At the start of Chapter 1, participants should identify the following topics for study:

- \* Reasons for change from prior law
- \* Categories of income & loss
- \* Fully taxable disposition
- \* Entire interest
- \* Other transfers
- \* Ordering of losses
- \* Regular & personal service corporations
- \* Real estate professionals
- \* Definition of pre-enactment interest
- \* Increase or decrease in pre-enactment interests

### Learning Objectives:

After reading Chapter 1, participants will be able to:

1. Recognize the broad impact of the §469 limitation provision by:
  - a. Recalling the differences between prior law loss treatment and the former and current treatment of losses;
  - b. Citing the prior tax shelter problem and Congress's motives and rationales in passing §469;
  - c. Specifying economic decision-making changes caused by the limitation;
  - d. Identifying income and loss into categories; and
  - e. Recognizing the concept of investor participation as central in determining the allowance of a passive loss.
2. Specify the mechanics of the passive loss rules, recognize the impact of §469 to appropriate deductions, identify what type of income may be offset by passive losses and then, determine a passive loss.
3. Identify passive losses under §469 by:
  - a. Citing the "bucket" analogy of §469 to:
    - (i) specify the categories of a client's annual income and the §469 limitation's impact, and
    - (ii) determine "passive items" and "material participation" under §469;

- b. Locating portfolio income based on items deemed nonpassive under the Code; and
  - c. Identifying circumstances that allow for special treatment of income and loss.
4. Recognize the suspension of disallowed losses, identify ways to ultimately "free up" passive losses, specify the treatment of passive credits including potential basis adjustment, and determine a fully taxable disposition indicating the impact of related party transactions.
  5. Identify the impact and tax consequences of a fully taxable disposition (FTD) by:
    - a. Determining an entire interest disposition, particularly for a partnership or grantor trust;
    - b. Specifying the allowance of suspended losses upon installment sale, exchange, gift, or death;
    - c. Selecting the order of recognized tax attributes upon an FTD; and
    - d. Recognizing ways to escape the application of the FTD and other passive loss rules particularly for closely held corporations and personal service corporations that change their operations and nature.
  6. Identify which clients are or are not subject to the passive loss rules by:
    - a. Specifying types of corporations to which §469 applies and citing the elements of their Code definitions;
    - b. Recognizing the general rental activity rule exception and eligibility requirements
    - c. Determining "pre-enactment interest," "qualified interest" and "pre-enactment activity" identifying their §469 "phase in" treatment; and
    - d. Citing §469's effective date and recognizing the IRS's application authority under 469(l).

After studying the materials in Chapter 1, answer exam questions 1 to 18.

<b>ASSIGNMENT</b>	<b>SUBJECT</b>
<b>Chapter 2</b>	<b>Material Participation</b>

At the start of Chapter 2, participants should identify the following topics for study:

- \* General rule
- \* Definition of "trade or business"
- \* TRA '86 committee report guidelines
- \* General rule for individuals
- \* Record keeping regulations
- \* Meaning of participation
- \* Limited partnership interests presumption
- \* Special rules for trusts & estates
- \* Special rules for retired & disabled farmers

\* Special rules for corporations

**Learning Objectives:**

After reading Chapter 2, participants will be able to:

1. Identify how to avoid the application of the passive loss rules through material participation, and factors under the TRA '86 that were considered in determining whether the taxpayer's involvement in the operation of the activity is regular, continuous, and substantial.
2. Specify tests provided by the initial February 19, 1988 regulations on material participation and how these tests provide useful §469 categories, determine participation and how to keep appropriate records of participation in an activity, identify exceptions to the definition of what counts toward material participation, specify the husband and wife rule associated with the passive loss rules, determine annual material participation.
3. Recognize special applications of the material participation rule by:
  - a. Citing the general rule for limited partnership interests and listing four exceptions;
  - b. Recalling its current application to trusts, estates, and certain corporations including members of an affiliated group and the rules for such entities; and
  - c. Determining the application of the material participation rule to retired or disabled farmers under the regulations.

After studying the materials in Chapter 2, answer exam questions 19 to 28.

<b>ASSIGNMENT</b>	<b>SUBJECT</b>
<b>Chapter 3</b>	<b>Activity Definition</b>

At the start of Chapter 3, participants should identify the following topics for study:

- \* Tax Reform Act of 1986
- \* Undertakings of old temporary activity regulations
- \* Aggregation of trade or business undertakings
- \* Integrated businesses
- \* Aggregation of professional service undertakings
- \* Control by the same interests
- \* Rental real property undertakings
- \* Participation unaffected
- \* Final simplified activity regulations
- \* Passive activity audit guide

**Learning Objectives:**

After reading Chapter 3, participants will be able to:

1. Recognize the history and rationale of the definition of "activity" by:

- a.** Specifying the impact of TRA '86, §183, and the at-risk rules specifying differences between the former complex definition and the final simplified regulations;
  - b.** Identifying why it is operationally important to separate activities and how activities were originally separated under the Committee Reports; and
  - c.** Citing Notice 88-94's role in determining separate activities.
- 2.** Identify the importance of the original undertaking rule used to determine an activity by:
  - a.** Recalling its legislative history including the early concepts of "undertakings," "separate source of income production" and "support operations;"
  - b.** Specifying the primary undertaking rule, its key variants such as aggregate, integrated and professional service undertakings and exceptions to the primary rule;
  - c.** Recognizing its provisions for controlled undertakings, permitted elective treatments and their effect on participation; and
  - d.** Identifying miscellaneous entity rules used for determining activities and reasonable and unreasonable methods of organizing operations.
- 3.** Determine the differences between the temporary, the final simplified activity regulations and their key elements by:
  - a.** Identifying factors used to determine whether two or more trade or business undertakings could be a single integrated business;
  - b.** Specifying rental activities, limited partnership activities, and partnership and S corporation activities according to their special rules, and citing conditions that permit a taxpayer to later regroup activities.
  - c.** Recognizing the tax consequences of inappropriate activity grouping and conditions permitting part of an activity to be a separate activity.
- 4.** Recognize the importance of the passive activity audit guide as a tool to avoid audit by:
  - a.** Specifying potential audit issues that the passive activity audit guide addresses whether or not a Form 8582 has been filed;
  - b.** Determining why investment interest deductions on Form 8582 and Schedule A are an indicator for an audit issue and the guide's focus on the material participation standard;
  - c.** Identifying indicators of significant participation activities, misstatements of active management and net lease arrangements;
  - d.** Determining when vacation rentals do not qualify for the \$25,000 offset and the material participation test must be met; and
  - e.** Specifying self-charged expenses, rental and nonrental activity grouping, and divorce transactions that can trigger audits.

After studying the materials in Chapter 3, answer exam questions 29 to 39.

**ASSIGNMENT****SUBJECT****Chapter 4****Passive and Non-Passive Activities**

At the start of Chapter 4, participants should identify the following topics for study:

- \* Trade or business
- \* Rental activity exemptions
- \* Rental of a dwelling unit
- \* Trading personal property
- \* Working interests in oil & gas exemption
- \* Entities that limit liability
- \* Disqualified deductions
- \* Activities within activities

**Learning Objectives:**

After reading Chapter 4, participants will be able to:

1. Determine the differences between passive activities and nonpassive activities under §469 by:
  - a. Recognizing a “trade or business activity” and the effect of participation on that characterization;
  - b. Specifying a “rental activity” identifying conditions for a rental activity to exist and the resulting passive presumption; and
  - c. Identifying exceptions to the general rule that rental activities are presumed passive.
2. Recognize the uncertain initial characterization of an activity and its potential recharacterization by:
  - a. Citing exceptions to passive activity status and their tax effect;
  - b. Determining a working interest in oil and gas based on financial risk and the special exemption to qualifying working interests;
  - c. Specifying forms of entities in which a taxpayer can hold an interest that is not deemed to properly limit the taxpayer’s liability when determining whether the activity is passive or nonpassive;
  - d. Identifying differences between limited liability and loss protection allowing the working interest passive treatment;
  - e. Specifying special oil and gas rules that can be applied when the taxpayer has disqualified deductions and the well produces a net loss and the rationale behind such rules; and
  - f. Recognizing the requirement of separate accounting for portfolio income of a passive activity from other items related to such activity and citing the basis for this rule.

After studying the materials in Chapter 4, answer exam questions 40 to 44.

**ASSIGNMENT****SUBJECT****Chapter 5****Passive Activity Loss**

At the start of Chapter 5, participants should identify the following topics for study:

- \* Working interest exception for husband & wife
- \* Separate accounting of disallowed items for husband & wife
- \* Net active income of closely held corporations
- \* Affiliated groups filing consolidated returns
- \* Treatment of carryover losses
- \* Allocation process
- \* Significant participation activities
- \* Separate identification of deductions

**Learning Objectives:**

After reading Chapter 5, participants will be able to:

1. Recognize the tax treatment of a passive loss including its identification, netting, and suspension by:
  - a. Determining a “passive activity loss” and its tax treatment;
  - b. Identifying the appropriate passive loss tax treatment of spouses and working interests in oil or gas;
  - c. Citing the special passive loss rule for closely held corporations; and
  - d. Determining an affiliated group’s passive activity loss using specified items of each group member.
2. Specify reasons why disallowed passive activity losses must be allocated among all the taxpayer’s activities producing a loss during the tax year, determine how to allocate disallowed passive activity losses and how they may be applied to multiple activities, identify the ratable portion of a loss and the ratable portion of a passive activity deduction under §469, and recognize significant participation activities and how to determine loss, if any.

After studying the materials in Chapter 5, answer exam questions 45 to 49.

**ASSIGNMENT**

**SUBJECT**

**Chapter 6**

**Passive Activity Gross Income**

At the start of Chapter 6, participants should identify the following topics for study:

- \* Income from dispositions of property used in passive activities
- \* Disposition of appreciated property formerly used in a nonpassive activity
- \* Rental activities
- \* Income from §481 adjustment
- \* Self-charged interest
- \* Exclusion of portfolio income
- \* Exclusion of personal service income
- \* Exclusion of oil & gas income
- \* Active business recharacterization



\* Portfolio income recharacterization rules

**Learning Objectives:**

After reading Chapter 6, participants will be able to:

1. Identify passive activity gross income by:
  - a. Determining “passive activity gross income” under §469;
  - b. Specifying income from the disposition of property used in a passive activity including mixed or alternating use property;
  - c. Recognizing the general treatment of rental activity income and gain from the disposition of appreciated property formerly used in a nonpassive activity; and
  - d. Citing conditions that must be met to offset up to \$25,000 per year of losses and credits related to a passive activity against nonpassive income.
2. Recognize the income characterization impact of a taxpayer’s relationship to an activity by:
  - a. Specifying the differences between active participation and material participation and the effect of changing participation;
  - b. Identifying the \$25,000 allowance, the aggregation of credits and deductions, allocation order, and generation of a potential net operating loss;
  - c. Selecting the differences between the activity treatment of a real estate dealer and a lessor of property particularly under a net lease; and
  - d. Determining the tax result of a positive §481 adjustment for an activity.
3. Identify specialty items and unique rules that complicate the calculation of gross passive income by:
  - a. Recognizing the dangers of self-charged interest and what measures can be taken to avoid this item’s passive nature identifying proposed regulations for dealing with such interest;
  - b. Citing the types of portfolio income that are not included in passive activity gross income;
  - c. Determining a “publicly traded partnership” for taxation purposes and how net income from such entities is portfolio income;
  - d. Recognizing safe harbors to be addressed in future regulations, and
  - e. Specifying types of income that are deemed compensation for personal services and their effect on portfolio income.
4. Determine tax attributes and subsequent events that can cause a recalculation of gross passive income by:
  - a. Identifying a loss from an oil and gas interest that is initially treated as nonpassive and income from a property whose basis is determined by reference to such property.
  - b. Citing additional miscellaneous exclusions from passive activity gross income;

c. Specifying types of income that are considered gross income derived in the ordinary course of a trade or business and their effect on portfolio income; and

d. Recognizing types of recharacterization rules, what type of conversion each prevents, and identifying whether certain transactions will be recharacterized based on the tests provided by the regulations.

After studying the materials in Chapter 6, answer exam questions 50 to 61.

<b>ASSIGNMENT</b>	<b>SUBJECT</b>
<b>Chapter 7</b>	<b>Passive Activity Deduction</b>

At the start of Chapter 7, participants should identify the following topics for study:

- \* Definition of passive activity deduction
- \* Qualified residence interest deduction exclusion
- \* Coordination with other deduction limitations
- \* Effect of coordination
- \* Losses on disposition
- \* Negative §481 adjustment
- \* Exceptions

**Learning Objectives:**

After reading Chapter 7, participants will be able to:

1. Determine a “passive activity deduction,” how it is processed under §469, and aggregate qualified residence interest using §469(j)(7), specify passive activity deductions with other deduction limitations, and identify effects the coordination rule has on the determination of passive activity deductions.
2. Recognize how to account for losses on disposition according to Reg. §1.469-2T(d)(5), cite instances that require such a loss to be allocated, determine a negative §481 adjustment, and specify exceptions to the passive activity deduction.

After studying the materials in Chapter 7, answer exam questions 62 to 67.

<b>ASSIGNMENT</b>	<b>SUBJECT</b>
<b>Chapter 8</b>	<b>Passive Activity Credits</b>

At the start of Chapter 8, participants should identify the following topics for study:

- \* Regular tax liability allocable to passive activities
- \* Exception for real estate rental activity credits
- \* Net active income
- \* Credits subject to passive activity limits
- \* Allocation of disallowed credits
- \* Separate identification of credits
- \* Ordering of credit limitations

- \* Special rule for partners & S corporation shareholders
- \* Coordination with other limitations
- \* Treatment of carryover credits

**Learning Objectives:**

After reading Chapter 8, participants will be able to:

1. Determine “passive activity credits” and the regular tax liability allocable to passive activities, cite the \$25,000 allowance according to the regulations, identify a closely held corporation’s passive activity credit net active income for the tax year and under §469, and determine how passive activity limitations apply to credits and how to allocate disallowed credits.
2. Specify circumstances where separate identification of credits is required and the order of credit limitations, cite the special rule for partners and S corporation shareholders, determine how passive activity credits match with other limitations, and identify the tax treatment of carryover passive activity credits.

After studying the materials in Chapter 8, answer exam questions 68 to 71.

<b>ASSIGNMENT</b>	<b>SUBJECT</b>
<b>Chapter 9</b>	<b>Items Received from Pass-Through Entities</b>

At the start of Chapter 9, participants should identify the following topics for study:

- \* Characterization of items received from pass-through entities
- \* Payments to partners as outsiders
- \* Payments to partners as partners
- \* Special rules for partnership liquidations
- \* Applicable valuation date for sale or exchange of interest
- \* Gain and loss dispositions
- \* Basis adjustments
- \* Aggregation of portfolio assets & default rule
- \* Tiered pass-through entities
- \* Restriction on conversion of nonpassive income

**Learning Objectives:**

After reading Chapter 9, participants will be able to:

1. Identify items received from pass-through entities as passive or nonpassive according to the passive loss rules, determine a taxpayer’s participation and the application of §469 to payments to partners as outsiders and as partners, specify the tax consequences of cash payments in liquidation of a partner’s interest, and identify categories of cash payments in such a liquidation.
2. Recognize items and events that uniquely adjust or allocate passive losses for pass-through entities and their owners by:

- a. Determining gain or loss from a sale or exchange of a partnership interest according to regulations and the applicable valuation date for such purposes;
- b. Identifying the ratable portion of any gain or loss allocable to such an entity conducted activity computing net gain or net loss and any §743(b) basis adjustment;
- c. Specifying the treatment of portfolio assets owned by pass-through entities allocating gain or loss according to regulation; and
- d. Determining the allocation of gain or loss from a disposition of an interest in a subsidiary entity and the special restriction on conversion of nonpassive income.

After studying the materials in Chapter 9, answer exam questions 72 to 76.

<b>ASSIGNMENT</b>	<b>SUBJECT</b>
<b>Chapter 10</b>	<b>Interaction with Other Code Sections</b>

At the start of Chapter 10, participants should identify the following topics for study:

- \* Application of passive loss rules
- \* At-risk rules
- \* Investment interest
- \* Characterization of passive activity income or deduction
- \* Coordination with §1211
- \* Husband & wife rules
- \* Corporations

**Learning Objectives:**

After reading Chapter 10, participants will be able to:

1. Recognize the application and ordering interaction of §469 with other Code sections by:
  - a. Specifying §469's restricted application to deductions from passive activities;
  - b. Identifying whether or when net passive losses from an activity:
    - (i) are deductible against other sources of income,
    - (ii) reduce a taxpayer's at-risk amount, and
    - (iii) impact attributable interest deductions;
  - c. Determining how passive activity income or deduction relate to §1211;
  - d. Recognizing the impact of the husband and wife rules of §§469, 704(d), 465 and 1366(d), and
  - e. Identifying tax provisions requiring coordination with §469.

After studying the materials in Chapter 10, answer exam questions 77 to 80.

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## **PASSIVE LOSSES**

**By  
Danny C. Santucci**

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