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From: [redacted]
Sent: Monday, February 10, 2014 3:43:08 PM
To: [redacted]
Cc: [redacted]
Bcc:
Subject: FW: 469 Question

This is to confirm our telephone conversation on Friday, February 7. You had indicated that Taxpayer owns interests in two activities. He also works full-time as an employee of a closely held C corporation in which he does not own an interest. The Taxpayer apparently argues that he should be able to group his two activities with the activity of the closely held C corporation to determine whether he materially participates in his own activities, pursuant to section 1.469-4(d)(5)(ii) of the regulations. As I indicated to you in our telephone conversation, for purposes of section 469, the "activities of a taxpayer" include only activities in which the taxpayer possesses an ownership interest. Our analysis is as follows:

Section 1.469-4(a) provides rules for grouping a taxpayer's trade or business activities and rental activities for purposes of applying the passive activity loss rules of section 469. A taxpayer's activities include those conducted through C corporations that are subject to section 469, S corporations, and partnerships.

Section 1.469-4(d)(5)(ii) provides that an activity that the taxpayer conducts through a C corporation subject to section 469 may be grouped with another activity of the taxpayer, but only for purposes of determining whether the taxpayer materially or significantly participates in the other activity.

In order to be "an activity of the taxpayer" the taxpayer must have an ownership interest in the trade or business activity or rental activity. Similarly, in order for a taxpayer to "conduct" an activity, the taxpayer must have an ownership interest in the activity. The grouping rules of section 1.469-4 may only be used to group together activities that are already "activities of the taxpayer", meaning that the taxpayer must have an ownership interest in each separate activity before those activities may be grouped together and treated as one activity for purposes of section 469. A trade or business activity cannot become an "activity of the taxpayer" simply by virtue of being

grouped with another activity of the taxpayer in which the taxpayer owns an interest. Accordingly, in this case, the Taxpayer may not group the trade or business activity of the closely held C corporation with any of the Taxpayer's own activities under section 1.469-4, because the Taxpayer does not have an ownership interest in the corporation. In this case, the corporation is simply the Taxpayer's employer, and nothing else.

In addition, this would raise the issue of whether the business activity of the corporation and the Taxpayer's own activities constitute an appropriate economic unit for the measurement of gain or loss for purposes of section 469, within the meaning of section 1.469-4(c)(1). We believe that the business activity of the corporation and the Taxpayer's own activities would not constitute "an appropriate economic unit for the measurement of gain and loss for purposes of section 469" as a matter of law. Any trade or business activity or rental activity that is conducted through an entity, whether it is an S corporation, partnership, or closely held C corporation, simply is not relevant to the measurement of gain or loss of a taxpayer for purposes of section 469 if the taxpayer does not possess an ownership interest in the entity.

Moreover, it would not make sense if a taxpayer could "group" the business activity of his employer with his own activities to determine material participation in his own activities simply because the taxpayer's employer happened to be a closely held C corporation (rather than another type of entity). We do not believe that the purpose of section 1.469-4(d)(5)(ii) was to give a special advantage to non-owner employees of closely held C corporations.

We believe that section 1.469-5(f)(1) provides further support for this position. Section 1.469-5(f)(1) provides that, with certain exceptions not relevant here, any work done by an individual (without regard to the capacity in which the individual does the work) in connection with an activity in which the individual owns an interest at the time the work is done shall be treated for purposes of this section as "participation" of the individual in the activity (emphasis added). Only an individual's "participation" in an activity, as defined in section 1.469-5(f)(1), will count towards meeting any of the safe-harbor tests for material participation under section 1.469-5T(a). The Taxpayer in this case did not have an ownership interest in the closely held C corporation at the time his work was performed and, therefore, the work does not count as "participation" in the Taxpayer's activities within the meaning of section 1.469-5(f)(1). Accordingly, any work performed by the Taxpayer for the corporation as a non-owner employee (assuming this work was not performed "in connection" with the conduct of the Taxpayer's own activities) would not count towards meeting the tests for material participation in the Taxpayer's own activities.

Note, however, that if an individual taxpayer performs work through a closely held C corporation (or through any other type of entity) as an employee (or in any other capacity), and the work was performed "in connection" with the taxpayer's own activities (within the meaning of section 1.469-5(f)(1)), that work might count towards material participation in the individual taxpayer's own activities. This would be true regardless of whether the taxpayer grouped (or could have grouped) his own activities with the

corporation's activity pursuant to section 1.469-4(d)(5)(ii). See, e.g., section 1.469-9(e)(3)(ii) (if a taxpayer manages his own properties through a separate property management company, his own work in managing his own properties through the company may count as participation with respect to those properties). The question of whether the work is properly treated as performed "in connection" with an activity in which the taxpayer owns an interest would be a factual issue, and the burden of proof generally would be on the taxpayer to substantiate that issue.

We hope this is helpful. If you have any additional questions or concerns, feel free to call me at the telephone number provided below.