

Passive Loss Limitations

Two (2) kinds of Income:

1. **PASSIVE** - Income and losses from the following activities are generally passive:

- Rental real estate (except rentals in which a real estate professional materially participates – IRC § 469(c)(7))
- Equipment leasing
- Sole proprietorship or farm in which the taxpayer does not materially participate (i.e. does not regularly work)
- Limited partnership interest, with some exceptions
- Partnership, S c, and limited liability company business in which the taxpayer does not materially participate

2. **NON-PASSIVE** - Income and losses from the following are generally non-passive:

- Salaries, wages, and Form 1099-Misc commissions
- Guaranteed payments
- Portfolio income (interest, dividends, royalties, gains on stocks and bonds)
- Sale of undeveloped land or other investment property
- Royalties
- Sole proprietorship or farm in which the taxpayer regularly works (i.e. materially participates)
- Partnership, S Corporation or LLC business in which the taxpayer materially participates.

The general rule in IRC § 469 provides that **passive losses can offset only passive income**.

Special limitation for Rental real estate losses: up to \$25,000 may be deducted by an individual whose modified adjusted gross income (MAGI) is less than \$100,000.

To qualify:

1. The taxpayer must actively participate, As long as a taxpayer participates in management decisions in a bona fide sense, he actively participated in the real estate rental activity. There is no specific hour requirement. However, the taxpayer must be exercising independent judgment and not simply ratifying decisions made by a manager.
2. own at least 10 percent and
3. not be a limited partner

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Phase Out:

The \$25,000 exception is **phased out** at the rate of 50 cents for every dollar of MAGI over \$100,000. Therefore, **when modified adjusted gross income (MAGI) exceeds \$150,000, the \$25,000 offset against other income is not allowed**. Suspended Losses Upon Liquidation of the Asset will trigger full release if:

1. On an entire disposition to an unrelated party in a fully taxable transaction, both current and
2. suspended losses may be deducted against wages, portfolio income and other non-passive income.
3. In other words, when you sell the property, all suspended losses may be deducted.