the final regulations generally adopt the rules contained in the proposed regulations.

II. Public Comments

Several comments requested that the Service reconsider the rule in the proposed regulations prohibiting qualifying taxpayers from grouping rental real estate activities with other activities in determining whether the taxpayers materially participate in the rental real estate activities. After careful consideration, the final regulations adopt the rule in the proposed regulations because that position is consistent with the statutory language and the legislative history.

Several comments suggested that the rule in the proposed regulations prohibiting the grouping of rental real estate activities with other activities be modified to allow qualifying taxpayers to group the activities of development or construction of rental real estate with rental real estate activities. The final regulations do not adopt this modification because in most cases development and construction activities are separate and distinct from rental activities. In addition, this modification would introduce significant administrative difficulties in determining which development activities or construction activities qualify. However, the IRS and Treasury Department invite comments concerning whether the material participation tests in § 1.469–5T(a) should be amended to include a look-back material participation test for taxpayers significantly involved in the development or construction of their rental real estate interests.

Several comments requested clarification regarding whether a qualifying taxpayer's participation in a management activity may count towards material participation in a rental real estate activity if the management activity includes the management of rental real estate owned by the taxpayer. The final regulations clarify that a qualifying taxpayer may participate in a rental real estate activity through participation in a management activity. In determining whether the taxpayer materially participates in the rental real estate activity, however, work the taxpayer performs in the management activity is taken into account only to the extent it is performed in managing the taxpayer's own rental real estate. The final regulations also clarify that a qualifying taxpayer who owns rental real estate through an entity, including a C corporation that is subject to section 469, may count work performed by the taxpayer in managing the rental real estate of the entity in establishing material participation in the taxpayer's rental real estate activities. Thus, if a qualifying taxpayer owns some interests in rental real estate through a closely held C corporation and makes the election to treat all interests in rental real estate as a single activity, the aggregate rental real estate activity will include those interests held through the closely held C corporation for purposes of material participation.

One comment requested that the regulations modify the definition of trade or business to clarify that a taxpayer's real property trades or businesses are determined without regard to the taxpayer's grouping of activities under § 1.469–4. The final regulations clarify that a taxpayer's grouping of activities under § 1.469–4 does not control the determination of the taxpayer's real property trades or businesses for purposes of this section.

Several comments requested that the regulations provide a detailed definition of real property trades or businesses beyond the cross-reference to section 469(c)(7)(C). However, to avoid complex and mechanical rules, the final regulations do not adopt a detailed definition of real property trades or businesses. Instead, the regulations provide that taxpayers may use any reasonable method for determining their real property trades or businesses.

Several comments requested that the final regulations modify the rule in the proposed regulations providing that only employees who are five-percent owners of their employer at all times during the taxable year may treat personal services performed as an employee as services performed in a real property trade or business. The comments suggested that the regulations should take into account personal services performed by employees that are five-percent owners for a significant portion of a taxable year. In response to these comments, the final regulations are modified to provide that an employee may count services performed in a real property trade or business during the portion of the taxable year that the employee is a five-percent owner in the employer.

Several comments requested clarification concerning whether a qualifying taxpayer that makes an election to treat all interests in rental real estate as a single activity will be treated as having a single rental real estate activity for purposes of the former passive activity rule under section 469 (f). In addition, comments requested that the regulations be modified to provide that qualifying taxpayers that make the aggregation election will be treated as having separate activities for purposes of the disposition rules under section 469(g) and § 1.469–4(g). In response to these comments, the final regulations clarify that a qualifying taxpayer that makes the election to treat all interests in rental real estate as a single rental real estate activity will be treated as having a single activity for all purposes of section 469, including sections 469(f) and (g). The statutory language and the legislative history do not support a rule allowing a qualifying taxpayer to treat all interests in rental real estate as a single activity for purposes of material participation and section 469(f), but as separate activities for purposes of section 469(g).

In addition, in response to comments, the final regulations provide an example illustrating the operation of the former passive activity rule for qualifying taxpayers that make the election to treat all interests in rental real estate as a single activity. This example illustrates that qualifying taxpayers that make the aggregation election may use current net income from the aggregate rental real estate activity to offset the prior-year disallowed passive losses of the aggregate rental real estate activity, regardless of which rental real estate interests within that activity produced the income or prior-year losses.

Some comments requested that the regulations permit qualifying taxpayers to make or revoke the aggregation election on an amended income tax return. After careful consideration of this issue, the final regulations adopt the rule in the proposed regulations that aggregation elections must be made or revoked on an original return. The final regulations provide, however, that the election may be revoked in any year in which the facts are materially changed from those in the taxable year for which the election was made.

In addition, one comment requested clarification as to what constitutes a material change in the facts and circumstances that would allow a taxpayer to revoke an aggregation election. However, the final regulations do not provide an example or bright-line rule for determining when a material change in the facts and circumstances has occurred, because this determination is intended to be a broad factual inquiry. Providing an example or bright-line rule may inappropriately restrict the scope of that inquiry.

One comment requested the modification of the rule in the proposed regulations that the aggregation election has no effect in years the taxpayer is not a qualifying taxpayer. Instead, the comment suggested that, for ease of administration and compliance, the