

aggregation election should be binding and irrevocable for all future years, including years in which the taxpayer is not a qualifying taxpayer. However, the final regulations adopt the rule in the proposed regulations because the position advocated by the comment would be unfavorable to many taxpayers and would not significantly improve administration.

Several comments requested that the regulations modify the rule in the proposed regulations treating each rental real estate interest of a passthrough entity as a separate interest of a person owning a fifty-percent or greater interest in the capital, gain, loss, income, deduction, or credit of the entity at any time during a taxable year. A commentator stated that this rule is burdensome on many passthrough entities and should be eliminated or modified. The final regulations modify this rule so that it applies only when a qualifying taxpayer owns a fifty-percent or greater interest in the capital, profits, or losses of a passthrough entity for a taxable year. Accordingly, this rule will not apply if a qualifying taxpayer owns a fifty-percent or greater interest in a single item of income or deduction but does not own a fifty-percent or greater interest in the overall capital, profits, or losses of the passthrough entity.

In response to one comment, the final regulations also clarify the application of the fifty-percent ownership rule to tiered passthrough entities. The final regulations provide that if a passthrough entity owns a fifty-percent or greater interest in the capital, profits, or losses of another passthrough entity for a taxable year, each interest in rental real estate of the lower-tier entity will be a separate interest in rental real estate of the upper-tier entity.

In response to another comment, the final regulations clarify that section 469(i) applies after the rules of section 469(c)(7) are applied. Accordingly, the \$25,000 offset will be applied only against passive losses from rental real estate activities, and not against losses that are allowable as a result of section 469(c)(7). In addition, the final regulations clarify that adjusted gross income for purposes of section 469(i) is not reduced by any losses from rental real estate that are allowable as a result of section 469(c)(7).

Several comments requested a modification to the effective date provision, to provide that aggregation elections made for taxable years beginning before January 1, 1995, are not binding for future years. Because taxpayers had sufficient notice of the rules of section 469(c)(7) and these regulations, this modification is

unnecessary and would add administrative complexity. Accordingly, the final regulations adopt the effective date provision of the proposed regulations.

Finally, in response to a comment, the activity regrouping rule of § 1.469-4(e)(2) is clarified to provide that a taxpayer may not regroup activities unless the taxpayer's original grouping was clearly inappropriate or there has been a material change in the facts and circumstances that makes the original grouping clearly inappropriate.

III. Effective Dates

In general, section 469(c)(7) applies for taxable years beginning after December 31, 1993. These regulations are effective for taxable years beginning on or after January 1, 1995. These regulations are also effective for elections under section 469(c)(7)(A) and paragraph (g) of these regulations that are made with returns filed on or after January 1, 1995.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is William M. Kostak, Office of Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * *

Section 1.469-9 also issued under 26 U.S.C. 469(c)(6), (h)(2), and (l)(1).

Par. 2. Section 1.469-0 is amended by:

1. Revising the entry for § 1.469-4(h).
2. Revising the heading for § 1.469-9 and adding entries for paragraphs (a) through (j) of § 1.469-9.
3. Revising the entry for § 1.469-11(b)(2) and removing the entries for § 1.469-11(b)(2)(i) and (ii).
4. Revising the entry for § 1.469-11(b)(3).
5. Adding an entry for § 1.469-11(b)(4).
6. The revisions and additions read as follows:

§ 1.469-0 Table of contents.

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§ 1.469-4 Definition of Activity.

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(h) Rules for grouping rental real estate activities for taxpayers qualifying under section 469(c)(7).

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§ 1.469-9 Rules for certain rental real estate activities.

- (a) Scope and purpose.
- (b) Definitions.
 - (1) Trade or business.
 - (2) Real property trade or business.
 - (3) Rental real estate.
 - (4) Personal services.
 - (5) Material participation.
 - (6) Qualifying taxpayer.
- (c) Requirements for qualifying taxpayers.
 - (1) In general.
 - (2) Closely held C corporations.
 - (3) Requirement of material participation in the real property trades or businesses.
 - (4) Treatment of spouses.
 - (5) Employees in real property trades or businesses.
- (d) General rule for determining real property trades or businesses.
 - (1) Facts and circumstances.
 - (2) Consistency requirement.
- (e) Treatment of rental real estate activities of a qualifying taxpayer.
 - (1) In general.
 - (2) Treatment as a former passive activity.
 - (3) Grouping rental real estate activities with other activities.
 - (i) In general.
 - (ii) Special rule for certain management activities.
 - (4) Example.
 - (f) Limited partnership interests in rental real estate activities.
 - (1) In general.
 - (2) De minimis exception.
 - (g) Election to treat all interests in rental real estate as a single rental real estate activity.
 - (1) In general.
 - (2) Certain changes not material.
 - (3) Filing a statement to make or revoke the election.
 - (h) Interests in rental real estate held by certain passthrough entities.