in the taxpayer's facts and circumstances. Similarly, a break in the taxpayer's status as a qualifying taxpayer is not, of itself, a material change in the taxpayer's facts and circumstances.

(3) *Filing a statement to make or revoke the election.* A qualifying taxpayer makes the election to treat all interests in rental real estate as a single rental real estate activity by filing a statement with the taxpayer's original income tax return for the taxable year. This statement must contain a declaration that the taxpayer is a qualifying taxpayer for the taxable year and is making the election pursuant to section 469(c)(7)(A). The taxpayer may make this election for any taxable year in which section 469(c)(7) is applicable. A taxpayer may revoke the election only in the taxable year in which a material change in the taxpayer's facts and circumstances occurs or in a subsequent year in which the facts and circumstances remain materially changed from those in the taxable year for which the election was made. To revoke the election, the taxpayer must file a statement with the taxpayer's original income tax return for the year of revocation. This statement must contain a declaration that the taxpayer is revoking the election under section 469(c)(7)(A) and an explanation of the nature of the material change.

(h) *Interests in rental real estate held by certain passthrough entities*—(1) *General rule.* Except as provided in paragraph (h)(2) of this section, a qualifying taxpayer's interest in rental real estate held by a partnership or an S corporation (passthrough entity) is treated as a single interest in rental real estate if the passthrough entity grouped its rental real estate as one rental activity under § 1.469–4(d)(5). If the passthrough entity grouped its rental real estate into separate rental activities under § 1.469–4(d)(5), each rental real estate activity of the passthrough entity will be treated as a separate interest in rental real estate of the qualifying taxpayer. However, the qualifying taxpayer may elect under paragraph (g) of this section to treat all interests in rental real estate, including the rental real estate interests held through passthrough entities, as a single rental real estate activity.

(2) *Special rule if a qualifying taxpayer holds a fifty-percent or greater interest in a passthrough entity.* If a qualifying taxpayer owns, directly or indirectly, a fifty-percent or greater interest in the capital, profits, or losses of a passthrough entity for a taxable year, each interest in rental real estate held by the passthrough entity will be treated as a separate interest in rental real estate of the qualifying taxpayer, regardless of the passthrough entity's grouping of activities under § 1.469–4(d)(5). However, the qualifying taxpayer may elect under paragraph (g) of this section to treat all interests in rental real estate, including the rental real estate interests held through passthrough entities, as a single rental real estate activity.

(3) *Special rule for interests held in tiered passthrough entities.* 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 held by the lower-tier entity will be treated as a separate interest in rental real estate of the upper-tier entity, regardless of the lower-tier entity's grouping of activities under § 1.469–4(d)(5).

(i) [Reserved].

(j) *$25,000 offset for rental real estate activities of qualifying taxpayers*—(1) *In general.* A qualifying taxpayer's passive losses and credits from rental real estate activities (including prior-year disallowed passive activity losses and credits from rental real estate activities in which the taxpayer materially participates) are allowed to the extent permitted under section 469(i). The amount of losses or credits allowable under section 469(i) is determined after the rules of this section are applied. However, losses allowable by reason of this section are not taken into account in determining adjusted gross income for purposes of section 469(i)(3).

(2) *Example.* The following example illustrates the application of this paragraph (j).

Example. (i) Taxpayer *A* owns building *X* and building *Y*, both interests in rental real estate. In 1995, *A* is a qualifying taxpayer within the meaning of paragraph (c) of this section. *A* does not elect to treat *X* and *Y* as one activity under section 469(c)(7)(A) and paragraph (g) of this section. As a result, *X* and *Y* are treated as separate activities pursuant to section 469(c)(7)(A)(ii). *A* materially participates in *X* which has $100,000 of passive losses disallowed from prior years and produces $20,000 of losses in 1995. *A* does not materially participate in *Y* which produces $40,000 of income in 1995. *A* also has $50,000 of income from other nonpassive sources in 1995. *A* otherwise meets the requirements of section 469(i).

(ii) Because *X* is not a passive activity in 1995, the $20,000 of losses produced by *X* in 1995 are nonpassive losses that may be used by *A* to offset part of the $50,000 of nonpassive income. Accordingly, *A* is left with $30,000 ($50,000–$20,000) of nonpassive income. In addition, A may use the prior year disallowed passive losses of *X* to offset any income from *X* and passive income from other sources. Therefore, *A* may offset the $40,000 of passive income from *Y* with $40,000 of passive losses from *X*.

(iii) Because *A* has $60,000 ($100,000–$40,000) of passive losses remaining from *X* and meets all of the requirements of section 469(i), *A* may offset up to $25,000 of nonpassive income with passive losses from *X* pursuant to section 469(i). As a result, *A* has $5,000 ($30,000–$25,000) of nonpassive income remaining and disallowed passive losses from *X* of $35,000 ($60,000–$25,000) in 1995.

Par. 5. Section 1.469–11 is amended as follows:

1. Paragraph (a)(2) is amended by removing ''; and'' and adding '';'' in its place.

2. Paragraph (a)(3) is redesignated as paragraph (a)(4) and a new paragraph (a)(3) is added.

3. Paragraph (b)(1) is revised.

4. The heading for paragraph (b)(2) is revised; the headings for paragraphs (b)(2)(i) and (b)(2)(ii) are removed; paragraph (b)(2)(ii) is removed, and paragraph (b)(2)(i) is redesignated as paragraph (b)(2).

5. Paragraph (b)(3) is redesignated as paragraph (b)(4).

6. A new paragraph (b)(3) is added.

The added and revised provisions read as follows:

§ 1.469–11 Effective date and transition rules.

(a) * * *

(3) The rules contained in § 1.469–9 apply for taxable years beginning on or after January 1, 1995, and to elections made under § 1.469–9(g) with returns filed on or after January 1, 1995; and

* * * * *

(b) * * * (1) *Application of 1992 amendments for taxable years beginning before October 4, 1994.* Except as provided in paragraph (b)(2) of this section, for taxable years that end after May 10, 1992, and begin before October 4, 1994, a taxpayer may determine tax liability in accordance with Project PS–1–89 published at 1992–1 C.B. 1219 (see § 601.601(d)(2)(ii)(b) of this chapter).

(2) *Additional transition rule for 1992 amendments.* * * *

(3) *Fresh starts under consistency rules*—(i) *Regrouping when tax liability is first determined under Project PS–1–89.* For the first taxable year in which a taxpayer determines its tax liability under Project PS–1–89, the taxpayer may regroup its activities without regard to the manner in which the activities were grouped in the preceding taxable year and must regroup its activities if the grouping in the preceding taxable year is inconsistent with the rules of Project PS–1–89.

(ii) *Regrouping when tax liability is first determined under § 1.469–4.* For the first taxable year in which a