

ACTIVITY GROUPING ELECTION

Aggregating Activities for Passive Loss Rules

The definition of an activity and whether a group of activities is treated as a single activity depends on facts and circumstances. The taxpayer can use "any reasonable method" to determine whether one or more trade or business activities constitute an appropriate "economic unit" for measuring gain or loss and thus may be treated as a single activity. The regulations list the following factors as those given the greatest weight in determining whether activities constitute an economic unit: (1) similarities and differences in types of business; (2) extent of common control and ownership; (3) geographic location; and (4) interdependencies between the activities (e.g., the extent to which the activities purchase or sell goods between or among themselves, involve products or services that are normally provided together, have the same customers or employees, or are accounted for with a single set of books).

Once the election to aggregate activities is made, the taxpayer may not regroup the activities unless the original grouping was clearly inappropriate or the facts and circumstances have changed so that the original grouping is no longer appropriate. Because the 3.8% net investment income tax (3.8% NIIT) may cause taxpayers to reconsider their previous grouping determinations, individuals may regroup their passive activities when they are initially subjected to the 3.8% NIIT. For this purpose, the determination whether the 3.8% NIIT would apply is made without regard to the effect of regrouping. An individual taxpayer may regroup his or her activities for any tax year that begins during 2013 if the 3.8% NIIT applies. A taxpayer may regroup activities impacted by the 3.8% NIIT only once, and a regrouping will apply to the tax year for which the regrouping is done and all subsequent years.

A rental activity cannot be grouped with a trade or business activity unless either activity is insubstantial when compared to the other activity. Furthermore, real property rentals and personal property rentals cannot be grouped together and treated as a single activity. However, where the provision of personal property is made in connection with the rental of real property (e.g., providing furniture for a rental apartment), a grouping of the activities is permitted. The IRS reserves the right to regroup any activities if the taxpayer's grouping fails to reflect economic reality and one of the primary purposes for the original grouping was to avoid the restrictions of IRC Sec. 469.

Under Rev. Proc. 2010-13, written disclosure statements are required to be filed with the tax return for the year in which two or more activities are grouped together for the first time (essentially serving as the election to group those activities), or for a year in which changes are made to existing groupings, including when a new activity is added to an existing group. See the sample election statement for the information required in the disclosure.

Who Can Elect

Individuals, closely held and personal service C corporations, S corporations, partnerships, estates and trusts. Activities are grouped at the entity level, but shareholders or partners can group those activities with other activities they conduct individually or through other pass-through entities. However, a shareholder or partner may not treat activities grouped by a pass-through entity as separate activities.

When to Elect

By the due date, including extensions, of the return for the year in which (1) two or more activities are first grouped together, (2) a new activity is added to an existing group, or (3) an existing group is regrouped. The disclosure requirements under Rev. Proc. 2010-13 are effective for tax years beginning on or after January 25, 2010.

How to Elect

By attaching a statement to the return, no disclosure is required to be made by pre-existing groupings that remain unchanged. Partnerships and S corporations are also not subject to the requirements of Sections 4.02 (new groupings), 4.03 (addition of new activities), or 4.04 (regroupings) of Rev. Proc. 2010-13. Instead, partnerships and S corporations must comply with the disclosure instructions for grouping activities provided for on Form 1065 (U.S. Return of Partnership Income) and Form 1120S (U.S. Income Tax Return for an S Corporation), respectively. Generally, compliance with the applicable form requires disclosing the entity's groupings to the partner or shareholder by separately stating the amounts of income and loss for each grouping conducted by the entity on attachments to the entity's annual Schedule K-1. Disclosure of the groupings disclosed by the entity under Sections 4.02, 4.03, and 4.04 of Rev. Proc. 2010-13 are not required unless the partner or shareholder (1) groups together

any of the activities that the entity does not group together, (2) groups the entity's activities with activities conducted directly by the partner or shareholder, or (3) groups the entity's activities with activities conducted through other Section 469 entities. Pursuant to Reg. 1.469-4(d) (5)(i), a shareholder or partner may not treat activities grouped together by a Section 469 entity as separate activities. In addition, the new disclosure rules do not apply to qualifying individuals who have made the real estate professional election [under IRC. Sec. 469(c) (7) (A) and Reg. 1.469-9 (g)] to group all rental real estate activities into a single activity.

Authorities and References

IRC Sec. 469; Reg. 1.469-4; Prop. Reg. 1.469-11(b) (3)(iv); Rev. Proc. 2010-13, 2010-41RB 329.

Sample Election

STATEMENT FILED IN ACCORDANCE WITH REV. PROC. 2010-13 AND ELECTION TO GROUP ACTIVITIES PURSUANT TO REG. 1.469-4(c)

Taxpayer's Name: _____ Tax year ending: _____

Taxpayer's ID No.: _____

The taxpayer hereby reports the following grouping activity in accordance with Rev. Proc. 2010-13:

New Groupings:

The following activities have been grouped as a single activity for the first time during the current tax year.

Name of Activity	Address	ID Number {If Applicable}	Type (business or rental)

Addition of Activities to an Existing Group:

The following activities have been added to a previously existing group during the current tax year.

<u>Name of Activity</u>	Address	ID Number (If Applicable)	Type {business or rental}
<u>Existing Activities</u>			
<u>Activities Added</u>			

Regrouping of Activities:

The following activities have been regrouped due to error in original grouping or a change in facts and circumstances during the current tax year.

Revised Grouping

<u>Name of Activity</u>	Address	ID Number (If Applicable)	Type (business or rental)

The following reasons are provided for this regrouping:

_____ hereby declares that any and all groupings created above constitute an appropriate economic unit for the measurement of gain or loss for purposes of IRC Sec. 469.

Note: The declaration is required for all disclosure reporting (e.g., new, additions, and revised groupings).