

Explanation

Passive Activity Rules: Activity Grouping Rules: Disclosure Requirements for Taxpayer Groupings

A taxpayer [must disclose to the IRS](#)^[1]—

- (1) the taxpayer's original grouping of activities for purposes of the [passive activity rules](#)^[2];
- (2) the addition of activities within groupings; and
- (3) the regrouping of activities where the original groupings were initially inappropriate due a to change in circumstances.

The [disclosure procedures](#)^[3] are set forth below. These procedures do not require a taxpayer to disclose the *disposition* of an activity within a chosen grouping.

Disclosing an initial grouping

A taxpayer (other than a partnership or S corporation) [must include a statement](#)^[4] with its original income tax return for the first tax year in which two or more trade or business activities or rental activities are first grouped as a single activity. The statement must—

- (1) identify the names, addresses, and employer identification numbers, if applicable, for the trade or business activities or rental activities that are being grouped as a single activity; and
- (2) contain a declaration that the grouped activities constitute an appropriate economic unit for the measurement of gain or loss for purposes of the [passive activity rules](#)^[5].

Disclosing the addition of new activities to existing groupings

A taxpayer (other than a partnership or S corporation) [must include a statement](#)^[6] with its original income tax return for the tax year in which the taxpayer adds a new trade or business activity or a rental activity to an existing grouping (regardless of the tax year that the initial grouping occurred). The statement must—

- (1) identify the names, addresses, and employer identification numbers, if applicable, for the new trade or business activity or rental activity that is being added to the existing grouping, as well as the names, addresses, and employer identification numbers, if applicable, for the activity or activities within the existing grouping; and
- (2) contain a declaration that the activities constitute an appropriate economic unit for the measurement of gain or loss for purposes of the [passive activity rules](#)^[7].

Disclosing the regrouping of an inappropriate original grouping

A taxpayer (other than a partnership or S corporation) is required to regroup the activities of an original grouping if the original grouping was clearly inappropriate or a material change in the facts and circumstances has occurred that makes the original grouping [clearly inappropriate](#)^[8] (see [Explanation: §469\(c\)](#)). The taxpayer [must include a statement](#)^[9] with its original income tax return for the tax year in which the taxpayer's trade or business activities or a rental activities are regrouped (regardless of the tax year that the original grouping occurred). The statement must—

- (1) identify the names, addresses, and employer identification numbers, if applicable, for the trade or business or rental activities that are being regrouped;
- (2) contain an explanation of why the taxpayer's original grouping was determined to be clearly inappropriate or the nature of the material change in the facts and circumstances that makes the original grouping clearly inappropriate; and

- (3) contain a declaration that the regrouped activities constitute an appropriate economic unit for the measurement of gain or loss for purposes of the [passive activity rules](#)^[10].

Special rules for groupings by partnerships and S corporations

Partnerships and S corporations are [not required](#)^[11] to include the three types of statements described above on their tax returns regarding their activity groupings. Except as listed below, partners and S shareholders do not file any of the preceding disclosure statements on account of an entity's groupings.

Partnerships and S corporations *are* required to comply with disclosure instructions for grouping activities that are provided for on [Form 1065](#), U.S. Return of Partnership Income, and [Form 1120S](#), U.S. Income Tax Return for an S corporation. Under these rules, the entity discloses its groupings to the partner or shareholder by separately stating the amounts of income and loss for each grouping on attachments to the entity's Schedule K-1.

The partner or shareholder is only required to make a separate disclosure of the groupings disclosed by the entity under the three disclosure rules listed above if 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 C corporations, S corporations, or partnerships.

A partner or shareholder [may not treat](#)^[12] activities grouped together by a partnership or S corporation as separate activities.

Failure to comply with disclosure requirements

If a taxpayer is engaged in two or more trade or business activities or rental activities and fails to report whether the activities have been grouped as a single activity according to the procedures set forth above, each trade or business activity or rental activity [will be treated as a separate activity](#)^[13] in applying the passive activity loss and credit limitation rules.

This treatment will not be apply, however, if—

- (1) *before the IRS discovers the failure to comply*, the taxpayer makes the disclosure in the tax year that it discovers it has failed to make the disclosure, and has filed all affected income tax returns consistent with the claimed grouping of activities; or
- (2) *after the IRS discovers the failure to comply* (i.e., the IRS discovers the failure to disclose first), the taxpayer has reasonable cause for not making the timely disclosure, and has filed all affected income tax returns consistent with the claimed grouping of activities.

The IRS, however, retains its [authority to regroup](#)^[14] a taxpayer's activities in order to prevent tax avoidance.

Citations

1. §1.469-4(e)
2. §469
3. REVPROC2010-13
4. REVPROC2010-13
5. §469

6. REVPROC2010-13
7. §469
8. §1.469-4(e)(2)
9. REVPROC2010-13
10. §469
11. REVPROC2010-13
12. §1.469-4(d)(5)(i)
13. REVPROC2010-13
14. §1.469-4(f)