
Internal Revenue Service

Passive Activity Loss

Audit Technique Guide (ATG)

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This material was designed specifically for training purposes only. Under no circumstances should the contents be used or cited as sustaining a technical position.

The taxpayer names and addresses shown in this publication are hypothetical. They were chosen at random from a list of names of American colleges and universities as shown in *Webster's Dictionary* or from a list of names of counties in the United States as listed in the *U.S. Government Printing Office Style Manual*.



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INTRODUCTION

The Audit Technique Guide (ATG) on Passive Activity Losses (PAL) has been significantly revised to reflect an issue-based format. Additionally, it has been updated to encompass current emerging issues, changes to Form 8582, Passive Activity Loss Limitation, and recent case law. The guide was developed to provide Revenue Agents and Tax Compliance Officers with technical information and tools to examine issues relating to both income and losses from passive activities.

This text provides specific guidance on potential audit issues along with summaries of the applicable Internal Revenue Code (IRC) and Federal Tax Regulations (Regulations) and highlights of common errors. We have attempted to write this ATG in plain layman's language, addressing issues which may be encountered on an audit. The text is not all encompassing and does not cover every exception. The IRC § 469, the related Regulations, and case law may have to be researched.

Included in the ATG are many job aids, designed to be used by examiners: a summary of court cases, checksheets for common issues, and decision trees. Examiners are reminded that the checksheets have been provided to assist the examiner, but are not all encompassing. The IRC § 469 and the related Regulations may have to be researched. In some instances, line numbers on various forms have been referenced. The examiner is reminded that line numbers may change from year to year. The job aids can be located at the end of each chapter. A summary of court cases and rulings can be located in the first exhibit in Chapter 1.

While certain provisions of the IRC § 469 are explained, the primary focus of this text is not an in-depth explanation of the law or Form 8582, but rather a guide to current and emerging audit issues. Regulations for activities (grouping rules for related entities), real estate professionals and self-charged interest have been finalized. However, the majority of the IRC § 469 regulations remain in temporary format. Temporary Regulations carry the same weight of authority as final regulations. Regulations have not yet been issued on dispositions and on trusts.

This material can be used in a classroom setting or as a self-study guide. Each lesson is designed to be self-contained. However, in most instances, Chapter 1, Overview, should be reviewed, as the concepts are intrinsic to an understanding of later lessons. Additional information on passive activities can be found at the PAL Intranet site or you can call the Passive Loss Technical Advisor, Lucy Clark, at (603) 433-0723.

A Quick Look Inside!

What's in here that would make me interested enough to go on.....?

- **Help with Form 8582** – Chapter 1
- **Cases** – very first exhibit in Chapter 1

Lots of issues you might see

- Equipment and vehicle leases – Chapter 2
- Real estate professionals – Chapter 2
- Rental real estate – Chapter 2
- Vacation condos, hotels, Bed & Breakfast (B&B) – Chapter 2

- Income issues on Form 8582 – Chapter 3
- Property leased to a business where the taxpayer works – Chapter 3
- Land leases – Chapter 3

- Material participation – Chapter 4
- What time does and does not count in the hourly tests – Chapter 4

- When losses are *not* triggered on disposition - Chapter 5
- When gain on disposition should *not* be on FORM 8582 – Chapter 5

- Issues with trusts (there's lots of them) – Chapter 6
- C corporation issues – Chapter 6
- Rules for Limited Liability Companies (LLCs) – Chapter 6
- Self-charged items – Chapter 6

- When interest expense is and is not deductible – Chapter 7
- Investment interest is limited to investment income – Chapter 7

- When the taxpayer's grouping might be wrong – Chapter 8
- When *you* might want to group related business – Chapter 8

- Issues with credits – Chapter 9

Checksheets, decision trees and other job aids at end of each chapter.

