JO Knows the Real Estate Professional Election

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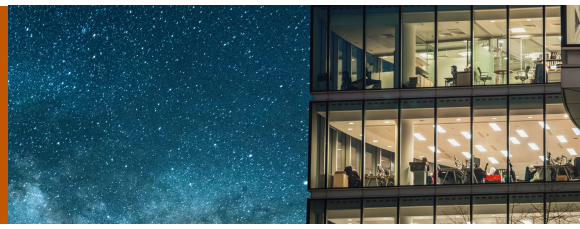

What are the benefits of being a real estate professional?

According to the IRS, real estate activities are generally considered "passive activities," and the taxpayer can only offset passive loss with passive income. Passive loss in excess of passive income in the tax year will be disallowed and carryforward to future years.

However, suppose the taxpayer qualifies and has elected to be treated as a real estate professional, the real estate activities will be treated as "nonpassive activities" where the loss could offset other ordinary income earned during the tax year, such as W-2 and self-employed income. In addition to that, since the real estate activities are not treated as passive activities, the income will also not be subjected to the 3.8% net investment income tax ("NIIT").

What are the requirements to be a real estate professional?

To qualify as a real estate professional, the taxpayer must meet all of the following three requirements. First, the taxpayer must work at least 750 hours in the tax year in real estate activities. Second, more than half of the working hours in the tax year must be in real estate activities. Third, the taxpayer must materially participate in real estate activities in the tax year. Generally speaking, a taxpayer is treated as materially participated in a business activity if the taxpayer is involved in the operation on a regular, continuous, and substantial basis or works more than 500 hours in the activity. In order to allow rental losses to offset other sources of income, you must have at least 500 hours of rental activity hours within the minimum 750 hours.

Taxpayers should have a log of tracking their hours for their various real estate activities, and this log should include the date, the length of time spent, the property it is associated with, and the work that was done. It should not be just a list of dates with the properties worked on.

Suppose the taxpayer has more than one real estate activity. In that case, the taxpayer can also choose to make an election to treat all real estate activities as one activity to meet the real estate professional requirements. If the taxpayer decides not to make the activity aggregation election, the requirements will be determined separately for each real estate activity.

Making the real estate professional election could be beneficial to taxpayers. However, a cost/benefit analysis should still be performed as the taxpayer has the burden of substantiating the real estate professional status every year.

If you would like to learn more about the real estate professional election and understand if the election would make sense for you, please do not hesitate to reach out.

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