



Real Estate Professionals

Sprague & Jackson

ACCOUNTANTS AND ENROLLED AGENTS

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Tax Benefits

If you spend significant time in activities related to real estate, you may qualify as a “real estate professional,” which can provide tax benefits.

Passive Loss Limits

A passive activity is generally defined as a business activity without a minimum amount of “material participation” by the taxpayer. A taxpayer is not allowed to deduct losses from passive activities in excess of income from passive activities. Any unused losses from passive activities must be carried forward until there are gains from passive activities, or until the passive activities that generated the losses are disposed of.

Special Rules for Real Estate Activities

Under passive loss rules, rental real estate activities are considered passive activities regardless of whether you meet the definition of “material participation.” In other words, for most rental real estate activities, losses in excess of income are not deductible in the year incurred.

Exception for real estate professionals. If you qualify as a real estate professional, passive activity loss limits do not apply to the losses from your rental activities. As a real estate professional, losses may be deducted in the year incurred even if the losses are greater than income.

Qualifying as a real estate professional. You will qualify as a real estate professional if both the following requirements are met.

- 1) More than half the personal services you performed in all trades or businesses during the tax year were performed in real property trades or businesses in which you materially participated, and

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- 2) You performed more than 750 hours of services during the tax year in real property trades or businesses in which you materially participated.

Personal services performed as an employee do not count unless you were a 5% or greater owner of the employer.

Real property trades or businesses include development, construction, acquisition, conversion, rental, operation, management, or brokerage of real property.

Note: If you work a full-time wage job (Form W-2), it is unlikely you would qualify as a real estate professional under (1), above, as you have to spend more time working in real estate than in any other work activity during the year. Both (1) and (2), above, must be met to qualify as a real estate professional.

Example: For 2023, Henry works full-time (2080 hours) as a software engineer. He also worked 800 hours managing his multiple rental properties. Henry does not qualify as a real estate professional, even though he exceeded the 750-hour requirement, because the 800 hours worked for his rental activity is not more than 2080 hours worked for his full-time job.

Material Participation

Material participation is defined as being involved in the activity on a basis that is “regular, continuous, and substantial.” You will be considered to materially participate in an activity if:

- 1) You participated in the activity for more than 500 hours during the year,
- 2) Your participation in the activity constitutes substantially all of the participation in the activity of all individuals for the tax year, including the participation of individuals who did not own any interest in the activity,

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