

# ADVANCED INDIVIDUAL TAXATION

Business 225K –Fall 2008

§469 Practice Set

Due 10/11/08

15 points

Your answers should be typed with each answer clearly labeled as to which question the answer pertains to. Citations to the primary authority supporting your answers must also be provided. In analyzing and answering the questions, be sure to think of all possible problems that the client could run into which you must check into and advise them about. This practice set is designed to improve your understanding of the topics covered in class – you’ll learn the materials better by applying them, not just reading about them or listening to your professor talk about them.

1. Jane owns a restaurant in San Jose, a restaurant in Los Gatos and a movie theater in Cupertino.
  - a. How many “activities” does Jane have?
  - b. The San Jose restaurant typically produces a loss and the Los Gatos one a gain. The theater always produces a loss. Assuming Jane materially participates in each business, what is the nature of her annual income and loss from each?
  - c. Same as (b) except that Jane does not materially participate in the theater. List possible helpful tax planning advice you can offer to Jane.
  - d. Assume Jane has been treating each operation as a separate activity and never participated in the Los Gatos restaurant. Her suspended PAL associated with it is \$12,000. This year she works over 500 hours in this restaurant and it generates income of \$1,500, which is not passive activity income (since Jane materially participates this year). What happens to Jane’s suspended PAL of \$12,000?
  
2. Larry recently made some money from exercising stock options and is taking advantage of so many foreclosures in the housing market by buying three residences to rent out. He plans to be an active landlord who is available to make repairs and do the gardening. His hours will likely total 10 per week.
  - a. How many activities will Larry have?
  - b. Assume that in year 1, the losses are as follows and Larry’s modified AGI is \$90,000. How much loss may Larry deduct in year 1? Does he have any suspended PAL to treat as a PAL for the next year?
    - i. Rental 1           \$12,000
    - ii. Rental 2           \$7,500
    - iii. Rental 3           \$8,100
  - c. Would you answer to (b) change if Larry also had a loss of \$2,500 from a partnership that operates an apartment complex and Larry is a limited partner?
  - d. How does your answer to (b) change if Larry’s modified AGI is \$130,000? What is his suspended loss, if any, per rental?
  - e. Assume Larry treated the rentals as a single activity. In 2012, he sells one of the rentals, generating a capital gain of \$20,000. Explain the tax consequences to Larry.
  - f. Do you need to know what Larry does for a living? Explain.

3. In June 2008, the Smiths retired, sold their home in San Jose, excluded the \$150,000 gain under IRC §121 and moved into their rental condo in Honolulu. At the time they converted the rental to personal use, they had a \$56,000 PAL associated with it (their AGI was always too high to be able to use §469(i)). The Smiths have no other passive activities. During retirement, their AGI will be about \$110,000 per year.

- a. Will the Smiths be able to apply §469(i) to the rental PAL once they retire to the condo and their AGI drops below \$150,000?
- b. Assume that in March 2009, the Smiths get tired of living in Hawaii and want to try Florida instead. They seek your advice on whether they should sell the Hawaii condo, or keep it as a rental (which will continue to produce about \$5,000 of PAL each year). They are not anxious to be long-distance landlords. A new home in Florida will cost about \$60,000 (they have \$40,000 downpayment and can easily borrow \$20,000 if necessary). The sale of the Hawaii condo will produce the following:

i. Adjusted sales price	\$240,000
ii. Adjusted basis	<u>(110,000)</u>
iii. Realized gain	\$130,000

What is the tax effect of selling the Hawaii condo (assume the PAL still exists)? (Ignore §121 here).