

# COURT CASES & OTHER GUIDANCE

## For use in

### DETERMINATION OF RENTAL REAL ESTATE TRADE OR BUSINESS

This is a compilation of court cases and other guidance, each concerning the rental real estate trade or business issue. This is to assist in determining whether a rental activity rises to the level of a trade or business. It may be appropriate to review the entire court case or other guidance if used in making a determination of trade or business. We suggest you use the checklist to gather information from your client to help you make an informed decision as to whether or not your client's rental real estate activity is a trade or business. You will notice that after the name of the case or other guidance there is a short description intended to capture the essence of the cited authority as to the rental real estate trade or business determination. We suggest you share your evaluation with your client and keep this evaluation in the client's file. Remember rental real estate trade or businesses with losses **reduce** QBI and the 20% sec 199A deduction. Rental real estate trades or businesses with net profits increase QBI and the section 199A deduction.

#### **(I) THRESHOLD ISSUE - PROFIT MOTIVE REQUIRED & FACTS CONTROL**

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(1) **HIGGINS v. COMMISSIONER, 25 AFTR 1160 (61 S. Ct. 475), (S Ct), 02/03/1941**

**Commentary** – “whether the activities of a taxpayer are ‘carrying on a business’ requires an examination of the facts in each case.” 312 U.S. at 217. Taxpayer must have a profit motive. Most rental real estate activities are a for profit activity. Vacation rentals, rental for less than fair rental value and hobby properties are examples of not-for-profit activities.

#### **(II) LEVEL OF ACTIVITY REQUIRED**

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(2) **COMMISSIONER V. GROETZINGER, 480 U.S. 23 (1987)**

**Commentary** – Activities must be “beyond the scope of mere ownership of property” **and** must be **considerable, regular, and continuous activity**. See generally Commissioner v. Groetzing, 480 U.S. 23 (1987) for “regular and continuous” requirements.

(3) **FINAL REGS SUMMARY OF COMMENTS & EXPLANATION OF REVISIONS – Sec 1.199A (Pg 22)**

As discussed in part II.A.3.a. of this Summary of Comments and Explanation of Revisions, generally under section 162, to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and the taxpayer's primary purpose for engaging in the activity must be for income or profit. Commissioner v. Groetzing, 480 U.S. 23, 35 [59 AFTR 2d 87-532] (1987).

**Commentary:** Final regulations require a taxpayer to be involved in a rental activity with continuity and regularity and the primary purpose to be for income or profit.

(4) **GENERAL COUNSEL MEMORANDUM (GCM) 38779**

The memorandum says Tax Court requires only a “**relatively small amount of activity**” for trade or business. – Tax Court has repeatedly ruled that one rental estate rental activity managed by the owner, including an agent or manager, meets the Groetzing standard of activities, which are “beyond the scope of mere ownership of property” and were deemed to be **considerable, regular, and continuous activity**.

### **(III) CASES INVOLVING A SINGLE RENTAL PROPERTY**

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**(5) LELAND HAZARD., 7 TC 372, Code Sec(s) 23, 07/16/1946**

Taxpayer occupied his property as a personal residence until such time as the TP relocated, at which point he rented the personal residence property and at the same time listed it for sale. The property was continuously rented for a period of about 3.5 years at which time it sold. The property was sold for \$18,500 for which the taxpayer reported an ordinary trade or business loss of \$6,844. No other activity was identified.

The IRS took the position that the home was a capital asset on the grounds that the rental was not a trade or business. The Tax Court found it to be a trade or business. The IRS subsequently acquiesced to this decision.

**Commentary** – A single rental, formerly a personal residence, was a trade or business – no specific other activity discussed.

**(6) ANDERS I. LAGREIDE., 23 TC 508, 12/22/1954**

"Taxpayer inherited a residence which she then rented out. The Commissioner there argued the rental of this single piece of residential property amounted to the operation of a trade or business regularly carried on by the taxpayer. The Tax Court agreed, saying: "It is clear from the facts that the real estate was devoted to rental purposes, and we repeatedly held that such use constitutes use of the property in trade or business, regardless of whether or not it is the only property so used. We add that the use of the property in trade or business was, upon the facts, an operation of the trade or business in which it was so used. It is clear, also, that the business was 'regularly' carried on, there having been no deviation, at any time, from the obviously planned use."

**Commentary** – A single residence was a trade or business – no specific other activity discussed as being required.

**(7) CURPHEY 73 T. C. 766(1980)**

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TP managed 6 units, but Tax Court made this remarkable statement regarding a single rental property being sufficient for trade or business. "This Court (Tax Court) has held repeatedly in cases subsequent to the Supreme Court decision in Higgins that the rental of even **a single piece of real property** for production of income constitutes a trade or business."; See also *Fegan*, 71 T.C. 791, 814 (1979); *Elek*, 30 T.C. 731 (1958), acq. 1958-2 C.B. 5; *Noble*, 7 T.C. 960 (1946), acq. 1946-2 C.B. 4., supra; *Hazard*, 7 T.C. 372 (1946), acq. 1946-2 C.B. 3.

**Commentary** –Single rental is a trade or business & husband agent OK.

### **(IV) CASES WHERE TAXPAYER TRIED TO RENT BUT FAILED**

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**(8) GEORGE S. JEPHSON., 37 BTA 1117, Code Sec(s) 23, 06/24/1938**

A taxpayer, who purchased a house for renting, listed it for rent with a broker and showed it to prospective tenants but failed to rent it, was engaged in a business, and is entitled to deductions for care and maintenance expenses and depreciation on the property.

**Commentary** – Taxpayer attempted to rent but was not successful, ruled to be a **trade or business**.

**(9) JACKSON V COMMISSIONER 34 T.C.M. 1139 (1975)**

“But the record here, while shedding little light on what affirmative steps may have been taken to rent the property, makes clear those measures that were not pursued. Petitioner did not employ a rental agent nor advertise in newspapers his willingness to rent the El Cajon property despite the fact that at times, similar measures were among those used in efforts to sell the property. Moreover, although the property was no longer suitable for occupancy by the time he reluctantly expressed a willingness to accept a tenant, he did not undertake to make any of the repairs that were required to put the property in rentable condition. Such inaction certainly raises doubts about the earnestness with which petitioner tried to rent the property”

**Commentary** – Purchased for sale-Attempt to rent not serious enough – **Not Trade or Business**

**(10) CAMPBELL v. COMMISSIONER 5 TC 272 (1945)**

Facts from evidence indicated that TP's “only purpose in buying the property ... was to rent it and that he tried to do so by listing it with a broker and showing it to prospective tenants, and that later he bought (another piece of property next door) ...as a step in assembling property on which to build an apartment house”.

**Commentary** – Attempt to rent was serious – **Trade or Business found**

**(11) ESTATE OF MARIA ASSMANN, 16 T.C. 632 (1951)**

Minimal unsuccessful efforts to rent not good enough. (See *Jackson* TCM 1965-275, to the same effect; also see *Redisch* TCM 2015-95, converted second home - unsuccessful attempt to rent - not a trade or business.

**Commentary:** Minimal unsuccessful attempts to rent **NOT a trade or Business.**

## **(V) LEVEL OF ACTIVITY REQUIRED TO BE HIGHER IN 2<sup>ND</sup> CIRCUIT BUT AGENT ACTIVITY COUNTS**

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**(12) 2<sup>ND</sup> CIRCUIT**

Activities must be “beyond the scope of mere ownership and the receipt (collection) of income and these activities must be “continuous” rather than sporadic, “regular” rather than irregular, and “considerable” rather than minimal.” (Keefe below; See *Alvary v. United States*, 302 F.2d 790, 796-797 (2d Cir. 1962); *Gilford v. Commissioner*, 201 F.2d at 736; *Pinchot v. Commissioner*, - 17 - [\*17] 113 F.2d 718, 719 (2d Cir. 1940); *Balsamo v. Commissioner*, T.C. Memo. 1987-477; *Grier*, 120 F. Supp. 395 at 398). Courts found that minimal activities with respect to the house as compared to the length of ownership, the lack of activity to rent or re-rent, and the absence of employees hired to regularly maintain or repair the premises did not rise to a trade or business - lack of “regular and continuous activity of management” under a facts and circumstances analysis.

**Commentary:** 2<sup>nd</sup> circuit requires the taxpayer's rental activities to be “continuous” rather than sporadic, “regular” rather than irregular, and “considerable” rather than minimal. *Grier*, 120 F. Supp. 395 at 398 is the seminal 2<sup>nd</sup> Circuit case)

**(13) GILFORD v. COMMISSIONER, 43 AFTR 221 (201 F.2d 735), (CA2), 02/05/1953**

Although it does not appear that the petitioner did anything herself in connection with the management of eight buildings, **an appreciable amount of time and work** was necessarily required on the part of the managing agent. And if such management was a "trade or business," the petitioner was so engaged although she acted only through an agent.

**Commentary** – Taxpayer's involvement in the rental was entirely through an agent, and the tax court ruled it to be a **trade or business**.

**(14) DAVID KEEFE, ET UX., TC MEMO 2018-28**

Maintenance and repairs supplied by the taxpayer or an agent of the taxpayer; the taxpayer's employment of labor to manage the property or provide services to tenants; the purchase of materials; the collection of rent; and the payment of expenses. See also *Alvary v. United States*, 302 F.2d 790, 796-797 [9 AFTR 2d 1633] (2d Cir. 1962); *Gilford v. Commissioner*, 201 F.2d at 736; *Pinchot v. Commissioner*, 113 F.2d 718, 719 [25 AFTR 447] (2d Cir. 1940); *Grier*, 120 F. Supp. 395 at 398. The totality of the facts and circumstances surrounding the use of the property must support a conclusion that the alleged rental activities were sufficient, continuous, and substantial enough to constitute a trade or business with respect to the rental of the property.

**Commentary:** More activity needed since this case was in the 2<sup>nd</sup> Circuit. "This Court will "follow a Court of Appeals decision which is squarely in point where appeal from our decision lies to that Court of Appeals and to that court alone." *Golsen v. Commissioner*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971). Court determined the Taxpayer's efforts were sufficient, continuous, and substantial enough to constitute a **trade or business**.

**(15) FACKLER 45 BTA 708, (19) aff'd 133 F2d 509, 30 AFTR 932 (CA-6, 1943)**

TP was responsible for expenses such as heat, light, water, insurance, real estate commissions, real estate taxes, miscellaneous expenses and repairs. **Trade or business found.** The sixth Circuit emphasized the importance of "rendering personal services to tenants" but did not elaborate on what those "personal services" were or are.

**(16) PETER S. ELEK, 30 TC 731, 06/26/1958**

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The taxpayer, a Hungarian who relocated to the U.S., had his father take over managing his apartment building in Budapest. The court determined the rental and management of an apartment building or residential property amounted to a trade or business of the owner, and this is true where an agent, in this case his father, acts for the owner.

**Commentary** – Agent did the management - Taxpayer's involvement in the rental was entirely through an agent, his father, and the tax court ruled it to be a **trade or business**.

## **(VI) AGRICULTURAL LAND LEASE CASES**

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**(17) BYRON K. ANDERSON, TC MEMO 1982-576., CODE SEC(S). 280A, 09/30/1982**

Taxpayer owned 80 acres of farm land which he leased to tenant farmer. The court agreed if the taxpayer had personally farmed the 80 acres it undoubtedly constitute a trade or business. However, he leased it to a tenant farmer thereby relieving himself of virtually all of the day-to-day responsibilities of farming and thus was not a trade or business.

**Commentary** – Farm land leased to a tenant farmer who did all of the day-to-day work, court ruled **NOT a trade or business**

(18) **GOOD V COMM 16 T.C. 906 (1951)**

For several years' petitioner rented 20 acres of land to tenants who raised hay and grain, the rent being in the form of a quarter share of the profits. For the remainder of the time petitioner rented the property as pasture for \$ 50 per year and during two or three years a 2-acre portion of it was rented for the storage of lumber, also for \$ 50 a year. When petitioner rented it for both pasture and as a lumber yard the total annual rental of \$ 100 exceeded the property taxes."

**Commentary** – Farm land leases to a tenant farmer - partially crop share and partially land lease - ruled a **trade or business**.

## **(VII) MISCELLANEOUS ISSUES**

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(19) **JACKIE H. ROBINSON, ET UX., TC MEMO 2014-120**

The Robinsons claimed **losses** for 2007 and 2008 derived from rental real estate expenses and depreciation on their Magnolia house. Though the Robinsons rented out the Magnolia house from 1995 through 1999 and again in December 2009, they received no rents in 2007 or 2008. The property was not held out for rent from 1999 until 2009, a 10-year period, and the Robinsons made no effort to sell the property. The tax court determined the Robinsons did not engage in a real estate trade or business or hold the Magnolia house out for the production of income. They failed to make any significant attempt to sell the property during the years at issue, and the house went unrented for the 10-year period encompassing the tax years at issue.

**Commentary** – Treatment as a rental was inconsistent, rented for 4 years, unrented for 10 years, then sold. Court ruled **NOT a trade or business**.

(20) **EDGAR PERRY, ET UX. V. COMMISSIONER, TC MEMO 2018-90 - RENTAL AT LESS THAN FRV**

The court found that the taxpayers failed to carry their burden of establishing that they rented petitioners' second house to petitioners' relatives at fair rental.

**Commentary** – Taxpayer rented the home for less than fair market to relatives. Thus, **NOT a trade or business**.

(21) **VICTORIA BALSAMO, TC MEMO 1987-477, 09/21/1987 - EVIDENCE NOT CREDIBLE & ACTIVITIES ALMOST NONEXISTENT**

Petitioner's activities with respect to the premises as rental property were almost nonexistent. Petitioner testified that the lessee, Economopoulos, pointed out to her a dead rat, a bee's nest, and several leaks during her single visit, yet petitioner presented no evidence that she attempted to remedy these problems during her period of ownership.

**Commentary:** Testimony and other evidence not credible, records incomplete, taxpayer activity almost nonexistent - very short rental period. The court found it was **NOT a trade or business**.

(22) **HAJOS 23 T.C.M. 2015 (1964) -PERSONAL RESIDENCE CONVERTED TO RENTAL**

Private personal residence for about 1½ years converted to rental for 1 ½ years till sold. Court found it to be a trade or business.

**Commentary:** Personal residence converted and sold within 1½ years was a **trade or business**.

**(23) STRATTON V. COMMISSIONER, T.C. MEMO 1962-218 - IRS ARGUED ONE RENTAL WAS A TRADE OR BUSINESS**

IRS argued "the mere renting of the house for the (three-year period) constituted the carrying on of a trade or business." Court determined it was a trade or business.

**Commentary:** In this case the IRS argued in favor of a trade or business. House rented for three years was a **trade or business**. The sole issue was whether the loss realized when the house was sold in 1951 was an ordinary loss deductible only in the year of the loss or a capital loss which can be carried forward to the years in question.

## **(VIII) OTHER GUIDANCE**

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**(24) NOTICE 2019-07**

This notice provides for 250 hours of rental services to achieve a safe harbor designation that a rental real estate enterprise is a trade or business. To qualify for the safe harbor contemporaneous records must detail (i) the hours of all services performed; (ii) description of all services performed; (iii) dates on which such services were performed; and (iv) who performed the services. It also requires the taxpayer to attach a statement, signed under penalty of perjury, that all the safe harbor requirements have been satisfied.

**Commentary:** Keep in mind the regulations specifically state that rentals can qualify under Sec 162, and the taxpayer need not meet Notice 2019-07's requirements to be a Trade or Business (see cases above)

**(25) TRIPLE NET LEASES**

Notice 2019-07 excludes triple net leases from qualifying under the safe harbor. In addition, triple net leases do not appear to qualify under Sec 162 either since the taxpayer provides no meaningful rental services.