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Lessons from the Tax Court: Are you a real estate pro?

Generally, your annual write-off for losses from passive activities is limited to your income from passive activities. In other words, you can't claim an overall passive loss on your tax return. A "passive activity" is one in which you do not "materially participate."

The IRS has established several tests for establishing material participation. For example, you're treated as a material participant if you spend more than 500 hours during the year on the activity. Rental real estate losses are generally treated as passive losses.

Under an exception, you can potentially deduct up to $25,000 of passive rental real estate losses even if you have no passive income. To qualify for the exception, you must "actively" participate in the rental activity, which is a looser standard than material participation.

The exception, however, phases out if your modified adjusted gross income (MAGI) for the year exceeds $100,000. It disappears completely for MAGI exceeding $150,000.

Conversely, there are no such limits on some rental real estate losses incurred by real estate professionals. Under the rental real estate exception for real estate professionals, you can fully deduct a rental real estate loss even if you have no passive income if:

- More than 50% of the personal services hours you perform in all trades or businesses during the tax year are performed in real property trades or businesses in which you materially participate.

- You spend more than 750 hours on your real property trades or businesses.

- You materially participate in the rental real estate activity.

If the IRS "puts you on the clock," you must prove that you've spent enough time to qualify as a real estate professional, even if you're in the business.

New decision: Mr. Calvanico, who was a licensed real estate appraiser and had a degree in real estate law, and Mrs. Calvanico, who also held a law degree, owned three rental condo units in a building. Although Mr. Calvanico worked as a real estate appraiser, he didn't have any ownership interest in his firm.

After the IRS denied the rental loss the couple claimed in 2010, the case went to court. But neither spouse could prove that they had logged enough time to qualify as a real estate professional. What's more, Mr. Calvanico couldn't count the time he spent on his job as a real estate appraiser. As a result, the couple's loss on their rental real estate activities was limited to their passive income. (*Calvanico, TC Summary Opinion 2015-64, 11/9/15*)

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