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September 22, 2014

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Re: Comments requested by the Preamble to [T.D. 9644](#) relating to the issue of material participation by a trust or estate in a trade or business for purposes of section 469 of the Internal Revenue Code

Dear Messrs. Koskinen, Wilkins, and Wilson, and Ms. Zarlenga:

The American Institute of Certified Public Accountants (AICPA) submits the comments below in response to the Preamble to T.D. 9644 published on December 16, 2013. The Preamble stated that the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) are currently studying the issue of material participation of trusts and estates in a trade or business for purposes of section 469 of the Internal Revenue Code (IRC or “Code”).¹ The preamble noted that Treasury and the IRS welcome any comments concerning this issue, including recommendations on the scope of any possible guidance and on specific approaches to this issue. This letter responds to that request.

The AICPA is the world’s largest member association representing the accounting profession, with more than 400,000 members in 128 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

¹ All references herein to “section” or “§” are to the IRC of 1986, as amended, or the Treasury Regulations promulgated thereunder.

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Executive Summary

The AICPA realizes that, after 28 years without guidance and two court decisions on which taxpayers are able to rely, the expanded scope of the section 1411 net investment income tax (NIIT) has created a broader need for all trusts and estates that have an interest in a trade or business to determine under section 469 whether the trust or estate materially participates in the trade or business.

If Treasury and the IRS choose to address this issue through regulations, we suggest that the guidance should:

- Incorporate the conclusions reached in the two court decisions;
- Thoroughly address the complicated issues involved;
- Provide comprehensive, administrable, and clear guidance;
- Count the combined activities of any trustee or executor who, under local law, has fiduciary duties and responsibilities with respect to the trust or estate, irrespective of the capacity in which the individual is performing those activities and irrespective of whether the individual also owns an interest in the same trade or business;
- Count the activities of employees and agents employed by the trust or estate to perform services in the trade or business;
- Provide that the material participation tests for individuals set forth in Temp. Reg. § 1.469-5T(a) apply to trusts and estates;
- Include a special rule to treat, for a certain period of time, an estate or former grantor trust as materially participating in any trade or business in which the decedent or deemed owner materially participated at the time of his or her death;
- Provide that the character of the income is determined at the level of the trust or estate, and the character of any distributed income remains the same in the hands of the beneficiary;
- Include a special rule to provide that the participation of the beneficiary of a qualified subchapter S trust (“QSST”) is used to determine whether the trust’s gain from the sale of the S corporation stock is treated as active or passive;

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- Include a special rule to provide that the S portion and the non-S portion of an electing small business trust (“ESBT”) are treated as a single trust for purposes of applying the section 469 rules.
- Provide that a trust or estate may qualify as a real estate professional under section 469(c)(7) and tests for how a trust or estate may qualify as a real estate professional.

I. Background

A. Section 469 and Temporary Regulations

Section 469 of the Internal Revenue Code, enacted in 1986, limits the amount of losses from passive activities that can be recognized each year to the amount of income from passive activities during the year. Any excess passive activity loss is disallowed for that year and carried over to subsequent taxable years. Section 469(c)(1) provides that a passive activity is any activity that involves a trade or business in which the taxpayer does not materially participate. Section 469(h)(1), in defining material participation, provides that a taxpayer is treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a regular, continuous, and substantial basis.

Trusts and estates are subject to the rules of section 469 pursuant to section 469(a)(2)(A). The passive activity rules have long been a problem for fiduciaries and beneficiaries of trusts and estates, particularly the material participation requirements, mainly because of the lack of guidance. Temporary Reg. § 1.469-5T(g) was reserved for regulations applying the material participation requirement to trusts and estates, but the regulations project was never completed and was closed.

There is guidance in Temp. Reg. § 1.469-5T on whether an individual materially participates in a trade or business. Meeting any one of the following seven tests results in the material participation threshold being met:

1. The individual participates in the activity for more than 500 hours during the year;
2. The individual’s participation in the activity for the taxable year constitutes substantially all of the participation in such activity of individuals (including individuals who are not owners of interests in the activity) for such year;
3. The individual participates in the activity for more than 100 hours during the taxable year, and such individual’s participation in the activity for the taxable year

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- is not less than the participation in the activity of any other individual (including individuals who are not owners of interests in the activity) for such year;
4. The activity is a significant participation activity for the taxable year, and the individual's aggregate participation in all significant participation activities during such year exceeds 500 hours;
 5. The individual materially participated in the activity for any five taxable years during the ten taxable years that immediately precede the taxable year;
 6. The activity is a personal service activity and the individual materially participated in the activity for any three taxable years preceding the taxable year;
- or
7. Based on all of the facts and circumstances, the individual participates in the activity on a regular, continuous and substantial basis during such year.

B. Section 1411 Net Investment Income Tax Has Created the Need to Determine Whether a Trust or Estate Materially Participates in a Trade or Business

Section 1411, added to the Code by the Health Care and Education Reconciliation Act of 2010, and effective for tax years beginning after December 31, 2012, imposes a tax on unearned income from investments of certain individuals, estates, and trusts whose income is above statutory threshold amounts. For an estate or trust, the tax is 3.8% of the lesser of the undistributed net investment income for the tax year, or the excess of the adjusted gross income (AGI) over the dollar amount at which the highest tax bracket in Section 1(e) begins for that tax year (\$12,150 for 2014).

Trusts or estates that had no losses from a trade or business had not previously been required to determine whether the income from a trade or business was active or passive. Section 1411 now requires those trusts and estates to make that determination. Thus, the need to determine whether a trust or estate materially participates in a trade or business is now an issue for all trusts and estates that have an interest in a trade or business. The expanded scope of the material participation rules apparently has resulted in renewed interest by Treasury and the IRS to address this issue after 28 years of silence.

C. Court Cases

The courts have addressed this issue in two cases, [*Frank Aragona Trust v. Commissioner*](#), 142 T.C. No. 9 (March 27, 2014), and [*Mattie K. Carter Trust v. U.S.*](#), 256 F. Supp. 2d

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536 (N.D. Tex. 2003). In *Aragona*, the Tax Court determined that the activities of the trustees, including their activities as employees of a limited liability company wholly owned by a trust, should be considered in determining whether the trust materially participated in its real estate trade or business. According to the court, the trustees were required by Michigan law to administer the trust solely in the interests of the trust beneficiaries because trustees have a duty to act as a prudent person would in dealing with property of another. The court quoted from *In re Estate of Butterfield*, 341 N.W. 2d at 457 – “Trustees who also happen to be directors of the corporation which is owned or controlled by the trust cannot insulate themselves from probate scrutiny [i.e., duties imposed on trustees by Michigan courts] under the guise of calling themselves corporate directors who are exercising their business judgment concerning matters of corporate policy.” The activities of two of the trustees were considered even though those individuals owned minority interests in all the entities through which the trust operated real estate holding and real estate development projects.

In footnote number 15 of the *Aragona* decision, the Tax Court stated that it did not need to decide whether the activities of the trust’s non-trustee employees should be considered for purposes of determining whether the trust materially participated in its trade or business. That issue, however, was addressed in the *Carter* case. In the *Carter* case, the District Court determined that the activities of a trust (through its trustee, employees, and agents) in a ranch it owned met the material participation requirement of section 469. The IRS took the position that only the activities of the fiduciaries (i.e., the trustees) should be considered in determining whether a trust had met the material participation requirement, based on a statement in the legislative history: “An estate or trust is treated as materially participating in an activity . . . if an executor or fiduciary, in his capacity as such, is so participating.” (S. Rep’t No. 99-313, 99th Cong., 2d Sess. 735 (May 26, 1986)). The court stated that it had studied the “snippet of legislative history” the IRS supplied that purports to lend insight on Congressional intent. The court explained, however, that legislative history is important only where the statutory language is unclear, and the court determined that there was no statutory ambiguity here. The court found that the trust was the taxpayer, and when the trust’s activities were taken into account, it was a material participant in the business.

II. General Comments

Section 469 has been applicable to trusts and estates for 28 years without any regulatory guidance concerning whose activities are to be considered when determining whether the trust or estate is materially participating in a trade or business. If Treasury and the IRS now choose to address this issue through regulations, we believe that the guidance should incorporate the conclusions reached in the two court decisions discussed above. In addition, we urge the IRS and Treasury to thoroughly study the complicated issues

involved and to issue comprehensive, administrable, and clear guidance. If the guidance is in a form other than regulations, the IRS and Treasury should provide a public comment period for such guidance in order to obtain thoughts from practitioners and taxpayers on the proposed guidance.

III. Specific Comments

A. Whose Participation

1. Grantor Trusts

A trust that is treated as owned by the grantor or another under sections 671-678 is referred to as a grantor trust. If the grantor trust owns an interest in a trade or business, the grantor's or deemed owner's participation in a trade or business is counted to determine whether income or loss from the trade or business is active or passive. Under section 1361(d)(1)(B), if the beneficiary of a trust makes the QSST election, the beneficiary is treated as the deemed owner under section 678(a) of the portion of the trust which consists of the S corporation stock. Therefore, the QSST beneficiary's participation in the trade or business of the S corporation is counted to determine whether the income or loss therefrom is active or passive.

2. Nongrantor Trusts and Estates

A nongrantor trust or estate acts through its fiduciaries. Therefore, in determining whether a trust or estate is materially participating in a trade or business, the participation of the entity's fiduciaries is the participation that needs to be measured. The determination of material participation must be made at the entity level. The participation of the beneficiary, who is not a fiduciary of the trust or estate, is immaterial for purposes of determining whether the trust or estate is materially participating in the trade or business.

If a trustee or executor is an individual, the regulations should provide that the individual's activities in a trade or business owned wholly or partially by the trust or estate are taken into account in determining whether the trust or estate materially participates in the trade or business. The regulations should provide that the activities of any trustee or executor who, under local law, has fiduciary duties and responsibilities with respect to the trust or estate are taken into account. Accepting the responsibility to become a fiduciary of a trust or estate is not an action that an individual undertakes lightly. By agreeing to accept fiduciary duties and responsibilities, the individual is no longer acting on his or her own behalf, but acting on behalf of all the beneficiaries of the trust or estate. These beneficiaries, as well as the courts, will hold the individual

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responsible for actions that breach his or her fiduciary duty. Thus, it should not concern the Treasury and the IRS that individuals who happen to actively participate in a trade or business might take on all the fiduciary duties and responsibilities entailed with serving as an executor or trustee only to ensure that the income or loss from an estate or trust's trade or business is not passive.

State law should not alone determine a person's status as a fiduciary. Section 7701(a)(6) and the regulations thereunder provide a definition of "fiduciary" for federal tax purposes. The regulations should provide that any person who meets the definition of a "fiduciary" under section 7701(a)(6) and who is materially participating in the trade or business in which the trust or estate owns an interest satisfies the material participation requirement for the trust or estate.

Any activities of the individual, who is a trustee or executor, should count toward the material participation determination, irrespective of the capacity in which the individual is performing those activities. The "snippet" of legislative history requiring the trustee to perform activities in the capacity as a trustee has been rejected by the courts as a standard in both *Aragona* and *Carter*. As a result, the proposed guidance should not include a capacity test.

The status or title of an individual working in a trade or business does not affect the determination of whether the individual is materially participating in a trade or business. Treasury Reg. § 1.469-5(f)(1) provides that any work performed by an individual (without regard to the capacity in which the individual does the work) in connection with an activity in which the individual owns an interest at the time the work is performed, is treated as participation of the individual in the activity. We believe this rule should also apply for fiduciaries of a trust or estate.

It is immaterial whether the individual, who is a trustee or executor, also owns an interest in the same trade or business in which the trust or estate owns an interest. Two of the trustees in *Aragona* owned minority interests in some of the businesses in which the trust owned an interest. The individuals' combined interest never exceeded 50 percent and was never greater than the trust's ownership interest. Similar facts may not be universally present. Nevertheless, even if the trustees own equivalent or larger interests than the trust or estate, the activities of the trustees in the trade or business should count for purposes of determining the trust's or estate's material participation. As the Tax Court stated, the interests of the individual owners, who were trustees, were generally compatible with the trust's goals – the trustees and the trust wanted the jointly held enterprises to succeed.

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If the trust or estate has multiple trustees or executors, the regulations should provide that the activities of all those individuals are considered in determining the material participation of the trust or estate in a trade or business. The material participation of any one trustee or executor in the trade or business should suffice to conclude that the trust or estate materially participates in said trade or business activity. For example, a trust with multiple trustees may assign one trustee to a particular task on behalf of the trust's board of trustees. The material participation standard should not require material participation on behalf of several or a majority of the trustees or executors.

For an individual, the material participation rules apply to individual activities (including multiple activities properly grouped as a single activity). A similar rule should apply to activities owned by a trust or estate. If the estate or trust has more than one activity, the same trustee or executor need not meet the material participation standard for each activity. One trustee or executor may qualify as materially participating in one activity, and a different trustee or executor may qualify as materially participating for a different activity.

The regulations should also provide that the activities of employees and agents employed by the trust or estate are taken into account in determining whether the trust or estate is materially participating in a trade or business wholly or partially owned by the trust or estate. As pointed out in the *Carter* case, the trust or estate is the taxpayer, and common sense dictates that the participation of the trust or estate in a trade or business is determined by reference to the trust or estate itself, which necessarily entails an assessment of the activities of those individuals who labor in the trade or business on behalf of the trust or estate.

B. Level of Activity

Once it has been decided whose activities need to be considered, the next determination is whether the trust or estate is materially participating in the trade or business. We suggest that the regulations provide several ways to meet the material participation standard. We suggest that if the activities of one fiduciary or the combined activities of more than one fiduciary in the operation of the trade or business are regular, continuous, and substantial, the trust or estate is materially participating in the trade or business. We also suggest that if the activities of the fiduciary through its employees and agents whose services are directly related to the conduct of the trade or business are regular, continuous, and substantial, the trust or estate is materially participating in the trade or business. The standard of "regular, continuous, and substantial" derives from the statutory provision and is also the seventh and final test for whether an individual is materially participating in a trade or business under Temp. Reg. § 1.469-5T(a)(7).

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The regulations should provide that the first six tests for material participation by an individual set forth in Temp. Regs. Sec. 1.469-5T(a) are available for trusts and estates. These tests are quantitative in nature. If an individual meets any of these tests, the IRS is satisfied that the individual's participation is not of a passive nature. These quantitative tests are equally applicable when applied to the activities of the fiduciaries of trusts and estates. For example, with respect to the first test of participating for more than 500 hours, the Preamble to [T.D. 8175](#) states that the IRS believes income from an activity in which an individual participates for more than 500 hours is not properly classified as a passive activity. Similarly, if the fiduciaries (either singularly or collectively) participate for more than 500 hours in a trade or business in which the trust or estate owns an interest, the activity is not properly classified as a passive activity. In addition, if an individual, who is a trustee of one or more trusts, participates for more than 500 hours during the year in a trade or business in which the individual and the trusts own interests, the individual and the trusts are all treated as materially participating in the trade or business.

The activities of the spouse of a married individual are counted for purposes of determining whether an individual materially participates in a trade or business under Temp. Reg. § 1.469-5T(f)(3). The activities of the spouse of an individual who is a fiduciary of an estate or trust should not count in determining whether the trust or estate materially participates in the trade or business. Fiduciary responsibilities are personal to the trustee. For example, suppose an individual does not participate in an activity for more than 500 hours during the year but meets the first test of Temp. Reg. § 1.469-5T(a)(1) because the combined participation of the individual and the individual's spouse exceeds 500 hours. The individual is considered to materially participate in the trade or business in which he or she owns an interest. If the individual is a fiduciary of a trust or estate that owns an interest in the same trade or business, the individual's hours of participation should count toward the participation of the trust or estate, but the hours of the individual's spouse should not count.

C. Special Rule for Estates and Certain Trusts after Death of Deemed Owner

We suggest the promulgation of a special rule for estates and for grantor trusts if the decedent or deemed owner materially participated in the trade or business prior to his or her death. For a certain period after the death of the decedent or deemed owner, the regulations should treat the estate or the former grantor trust as materially participating in any trade or business in which the decedent or deemed owner materially participated at the time of his or her death. For an estate and a qualified revocable trust that makes the election under section 645 to be treated as part of the estate, the period should match up with the section 645 election period (i.e., two years after the decedent's death if no federal estate tax return is required to be filed, or 6 months after the date of the final

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determination of estate tax liability if an estate tax return is required to be filed). If the deemed owner of a grantor trust materially participated prior to death, the former grantor trust is treated as materially participating for two years after the deemed owner's death.

The regulations should not immediately subject any interest that has been active and not subject to the loss limitations of section 469 or the excise tax in section 1411 prior to a decedent's or deemed owner's death to those provisions merely because the owner has died. This rule will allow an estate time to distribute to the ultimate beneficiaries its interests in a trade or business without dramatically changing the tax treatment of the interest in the trade or business during the period of estate administration. A similar rule for the two year period following the deemed owner's death will allow former grantor trusts time to make distributions or to involve the trustees in the trade or business if the trust is to continue.

D. Character of Income Distribution to Beneficiary

Section 1.652(b)-1 provides that in determining the gross income of a beneficiary, the amounts includible have the same character in the hands of the beneficiary as in the hands of the trust. Thus, the character of the income remains the same whether the income is retained by the trust or passed through to the beneficiary under section 651 or 661. The regulations should provide that once the income is determined to be active or passive at the trust or estate level, such income remains active or passive in the hands of the beneficiary if it is treated as distributed to the beneficiary under section 652 or section 662. There should be no redetermination of the character of the income based on the beneficiary's participation or lack of participation in the activity.

E. Special Rule for Gain From Disposition of S Corporation Stock by QSST

When a QSST sells its stock in the S corporation, the QSST beneficiary originally was required to recognize the gain on the sale under Rev. Rul. 92-84, 1992-2 C.B. 216. The IRS and Treasury reconsidered this position and determined that the QSST beneficiary who is treated as a deemed owner under section 678 of the S corporation stock solely by reason of section 1361(d)(1) should not be treated as the owner of the consideration received by the trust upon its disposition of the S stock. Revenue Rul. 92-84 was declared obsolete when Treas. Reg. § 1.1361-1(j)(8) was promulgated in 1995. Treasury Reg. § 1.1361-1(j)(8) provides that the trust, rather than the income beneficiary of the QSST, is required to recognize the gain on the sale of stock in the S corporation. Treasury Reg. § 1.1361-1(j)(8) also provides that solely for purposes of applying sections 465 and 469 to the income beneficiary, a disposition of S corporation stock by a QSST is treated as a disposition by the income beneficiary.

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If the QSST beneficiary is materially participating in the S corporation prior to the sale of the S corporation stock, all the income or loss from the stock is not passive. The gain on the sale of the stock should reflect the treatment of the income or loss immediately prior to the sale and, therefore, should also not be passive. However, unless a special rule is promulgated, the gain on the sale of the stock is passive in the hands of the trust because the trust has not materially participated in the S corporation. The regulations should provide that the trust is allowed to use the participation of the QSST beneficiary in determining whether the trust's gain on the sale of the stock is active or passive.

F. Special Rule for Electing Small Business Trusts

In general, for federal income tax purposes, an ESBT consists of an S portion, a non-S portion, and in some instances, a grantor portion. The items of income, deduction, and credit attributable to any portion of the ESBT treated as owned by a person under the grantor trust rules of subpart E, including S corporation stock and other property (the grantor portion), are taken into account on that individual's tax return pursuant to the normal rules applicable to grantor trusts. Other items of income, deduction, and credit are attributed to either the S portion, which includes the S corporation stock, or the non-S portion, which includes all other assets of the trust. Treasury Reg. § 1.641(c)-1(a) provides that an ESBT is treated as two separate trusts for purposes of Chapter 1. The S portion is subject to tax under the special rules of section 641(c), while the non-S portion is subject to the normal trust taxation rules of Subparts A through D of subchapter J.

The requirement of Treas. Reg. § 1.641(c)-1(a) that an ESBT be treated as two separate trusts follows the Congressional intent expressed in section 641(c)(1)(A) that the portion of the trust consisting of stock in one or more S corporations be treated as a separate trust and the tax on the separate trust be computed under the special rules set forth in section 641(c)(2), rather than under the traditional Subchapter J rules. This artificial separation causes many unintended results when applying the passive loss rules of section 469. In some instances, the separation of the ESBT into an S portion and a non-S portion produces taxpayer-favorable results, and in other cases it produces taxpayer-unfavorable results. But in both situations, we do not believe that an ESBT with activities held in both the S portion and non-S portion should have a materially different outcome under the section 469 rules than a nongrantor trust that holds its activities in partnership form.

In order to eliminate the discrepancy between ESBTs and traditional non-grantor trusts, we recommend that, solely for purposes of the application of the rules in section 469, the S portion and non-S portion of the ESBT be considered a single trust. As a result, all provisions of section 469 would be applied to the trust as a single taxpayer including, but not limited to, the income recharacterization rules, grouping, material participation, and self-charged interest rules. As an alternative approach, we recommend that the S portion

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and non-S portion of the ESBT be considered a single trust in select situations. For example, we recommend that an ESBT be permitted to group activities in the S portion with activities in the non-S portion under Treas. Reg. § 1.469-4. Furthermore, material participation should be determined under Treas. Reg. § 1.469-5T for the both the S portion and non-S portion as a single trust, and not as two separate trusts where each portion would require separate books, records, and substantiation. Finally, the rules applicable to recharacterizations of self-charged rent and interest in Treas. Reg. § 1.469-2(f)(6) and Treas. Reg. § 1.469-7, respectively, should be applied to a unified trust. Under both recommendations, the ESBT would be treated substantially similar to a traditional nongrantor trust. However, under the broader approach, the single unified treatment of the ESBT represents a broad and malleable policy, whereas the second approach is a limited, targeted provision that will have to be monitored and updated as the general treatment of section 469 to nongrantor trusts evolves over time.

G. No Special Rule for Charitable Remainder Trusts

One issue is the possible need for a special rule that would allow the use of the grantor's participation if the grantor is the annuity or unitrust beneficiary of a charitable remainder trust (CRT). Section 664(c)(2)(A) imposes an excise tax on a CRT equal to the amount of the CRT's unrelated business taxable income (UBTI) within the meaning of section 512. As a result of the 100 percent excise tax on UBTI, most CRTs no longer have any investments in trades or businesses. Therefore, we believe there is no need for a special rule for CRTs.

H. Trust Can Be Real Estate Professional

Generally, a rental real estate activity is considered per se a passive activity under section 469(c)(2). Section 469(c)(7) provides that section 469(c)(2) does not apply to the rental real estate activity of any taxpayer who meets the two tests set forth in section 469(c)(7)(B). The first test is met if more than one-half of the personal services performed in trades or businesses by the taxpayer during the taxable year is performed in real property trades or businesses in which the taxpayer materially participates. The second test is met if the taxpayer performs more than 750 hours of services during the year in real property trades or businesses in which the taxpayer materially participates.

The Tax Court in *Aragona* held that a trust may qualify for the real estate professional exception of section 469(c)(7) and that "the activities of the trustees...should be considered in determining whether the trust materially participated in its real-estate operations." We recommend that the regulations should incorporate the conclusions of *Aragona* that an estate or trust can qualify as a real estate professional under section 469(c)(7).

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Due to stipulations by the parties, the *Aragona* court did not have to deal with the application of the two tests of section 469(c)(7)(B). While we acknowledge some of the difficulties in applying these tests to estates and trusts, we suggest two approaches that we believe will ease tax administration and improve compliance. If the trust or estate satisfies either of these approaches, the trust or estate would qualify as a real estate professional under section 469(c)(7).

Under the first approach, regulations would provide, for purposes of the real estate professional exemption of 469(c)(7), the “more than one half of the personal services” test of section 469(c)(7)(B)(i) and the “more than 750 hours” test of section 469(c)(7)(B)(ii) are met by looking at the activities of a single individual who is a fiduciary of the trust or estate or who is acting for a fiduciary of the trust or estate. The regulations could require that all hours offered as qualifying under the “more than 750 hours” test are incurred in the real estate businesses in which the estate or trust owns an interest. All trade or business personal services of this person, whether or not performed in the trades or businesses in which the estate or trust owns an interest, are considered in the “more than one half” portion of this test. The regulations could require that more than 50% of these services are in real estate trades or businesses in which the estate or trust owns an interest and in which the individual materially participates.

Under the second approach, we suggest that the regulations use the authority granted to the Secretary of the Treasury by Congress in section 469(l)(1) to create a more easily calculated test. Under section 469(l)(1), the Secretary may prescribe regulations to “specify what constitutes an activity, material participation, or active participation for purposes of this section.” This approach is based on section 469(c)(7)(D), which provides that closely held C corporations may qualify for real estate professional status under section 469. As the *Aragona* court noted, this section shows that Congress did not intend to restrict real estate professional status only to individuals.

The regulations would provide that an estate or trust attains real estate professional status if the greater than 50% of gross receipts test of section 469(c)(7)(D) is met and the estate or trust would qualify as a closely held C corporation if the estate or trust were a C corporation and all beneficiaries were stockholders. Section 469(j)(1) defines a closely held C corporation as any C corporation described in section 465(a)(1)(B), which includes any C corporation with respect to which the stock ownership requirement of section 542(a)(2) is met. The stock ownership requirement of section 542(a)(2) requires that more than 50 percent in value of the corporation’s outstanding stock is owned, directly or indirectly, by or for not more than 5 individuals. The stock attribution rules of section 544 are used to determine who directly or indirectly owns the stock for purposes of section 542(a)(2). In applying these rules to a trust or estate, the beneficiaries would

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be treated as if they were shareholders of the C corporation. Only beneficiaries who meet the definition of a “potential current beneficiary” in section 1361(e)(2) would need to be considered.

I. Other Potential Issues

As we mentioned earlier, we suggest the relevant guidance issued by the IRS and Treasury thoroughly address the complicated issues involved and provide comprehensive, administrable, and clear rules. In addition, the AICPA has identified some issues unrelated to material participation that arise with respect to trusts and estates that the IRS and Treasury may wish to address. As the IRS and Treasury develop detailed guidance and decide the scope of the project, the AICPA is available to discuss additional issues with IRS and Treasury.

For example, there are several issues relating to the treatment of a passive activity loss (“PAL”) when the status of the trust changes or distributions are made from the trust or estate to a beneficiary. For example, what happens to the PAL if a trust ceases to qualify as a grantor trust during the deemed owner’s lifetime or a nongrantor trust becomes a grantor trust? Also, what happens to the PAL when:

- a. A trust terminates, but a related party has not disposed of the interest in the trade or business;
- b. The election is made under section 643(e) to treat the distribution as a deemed sale; and
- c. The distribution satisfies a pecuniary bequest?

There are also issues related to the treatment of depreciation and depletion and whether these items transfer to trust beneficiaries under section 167(d) and section 611(b)(3), respectively, or whether they are suspended at the trust or estate level as part of the passive loss under section 469.

* * * * *

We welcome the opportunity to discuss these comments or to answer any questions that you may have.

I can be reached at (304) 522-2553, or jporter@portercpa.com; or you may contact Eric L. Johnson, Chair, AICPA Trust, Estate, and Gift Tax Technical Resource Panel, at ericljohnson@deloitte.com; or Eileen Sherr, AICPA Senior Technical Manager, at 202-434-9256, or esherr@aicpa.org.

The Honorable John A. Koskinen
The Honorable William J. Wilkins
Ms. Lisa Zarlenga
Mr. Curtis G. Wilson
September 22, 2014
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Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey A. Porter". The signature is fluid and cursive, with the first name "Jeffrey" being the most prominent.

Jeffrey A. Porter, CPA
Chair, Tax Executive Committee

cc: Ms. Catherine Veihmeyer Hughes, Estate and Gift Tax Attorney Advisor, Office of
Tax Policy, Department of the Treasury
Mr. David Haglund, Chief Branch 1, Office of the Associate Chief Counsel for
Passthroughs and Special Industries, Internal Revenue Service
Ms. Adrienne Mikolashek, Office of Chief Counsel for Passthroughs and Special
Industries, Branch 1, Internal Revenue Service