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IRS Proposes New Passive Activity Grouping Rules **Grouping of Your Aircraft into Your Primary Business**

One of the most potent weapons of the IRS in challenging aircraft deductions is to classify them as a passive activity. Passive activity losses may not be used against other income to reduce income tax liability other than from other passive activities. On the other hand, if a loss is not classified as passive it may be used to offset income from any source derived.

If an aircraft is used to support a business that the taxpayer is actively engaged in, the taxpayer may elect to treat both businesses as a single undertaking; therefore the combined business becomes active. The regulations on this election have never clarified what steps the taxpayer must take to make the "grouping" election. On August 1, 2008, the IRS issued Notice 2008-64 in which it solicits comments on a proposal to require taxpayers to affirmatively disclose groupings and regroupings of their activities and note the addition and disposition of specific activities.

PROPOSED REPORTING

IRS is considering whether to change the reporting requirements for taxpayer groupings under [Code Sec. 469](#). Although IRS has considered a number of approaches, the proposal described in [Notice 2008-64](#) would generally require taxpayers to report to IRS, as part of their regular annual return, changes to their groupings. The proposal would apply to all persons or entities to whom the rules in [Reg. §1.469-4](#) apply. It would not apply to persons or entities who have made the election in [Reg. §1.469-9\(g\)](#), relating to real estate professionals.

Specifically, the proposal would require a statement with specified information as detailed in [Notice 2008-64](#) to be filed with respect to these events:

New groupings. A taxpayer would have to file a written statement with his original return for the first tax year in which one or more trade or business activities or rental activities are originally grouped as a single activity or as separate activities.

Addition of new activities to existing groupings. Whenever a taxpayer adds a new trade or business activity or a rental activity to an existing grouping within a tax year, he would have to file a written statement with his original return for the tax year in which the new trade or business activity or rental activity is added to the existing grouping.

Disposition of activities from existing groupings. Whenever a taxpayer disposes of a specific activity from an existing grouping within a tax year, he would have to file a written statement with his original return for the tax year in which the disposition of the specific trade or business activity or rental activity within the existing grouping occurs.

Regroupings. Under Reg. § 1.469-4(e)(2), if it is determined that the taxpayer's original grouping was clearly inappropriate or a material change in the facts and circumstances has occurred that makes the original grouping clearly inappropriate, the taxpayer would have to regroup the activities and file a written statement with his original return for the tax year in which the regrouping occurs.

FAILURE TO REPORT

In general, if a taxpayer failed to report, then each trade or business activity or rental activity would be treated as a separate activity for purposes of applying the passive activity loss and credit limitation rules.

EFFECTIVE DATE

The proposal would be effective on the date that final guidance is published by IRS.

COMMENT

Although Notice 2008-64 is a mere solicitation of comments on proposed disclosure of grouping activities, taxpayers may be well served to make the disclosure with their next tax return to provide evidence of their grouping intent. The regulations specify that the taxpayer's election will normally be respected, and rarely will an aircraft owner find a grouping election detrimental to their tax positioning. For further discussion of grouping your trades or business, see *Electing to Group Your Aircraft with Your Operating Business May Yield Income Tax Savings* at www.advocatetax.com.

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