REAL ESTATE, TRUST AND PROBATE LAW JOURNAL

Recent Developments in Oil and Gas and Real Estate Taxation

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1. Real Estate Tax Matters.

1.01. In *Rapp v. Commissioner*, U.S.T.C. 2017-14, the taxpayer was involved as an employee of two firms in the development of commercial real estate. Taxpayer worked full time in connection with this activity. Taxpayer was the property manager for his five rental properties but did not provide any evidence about how much time he spent on his rental activities during the year. Taxpayer did not own any interest in the two real estate businesses that employed him but he had been told he might receive an equity interest if he developed an independent project. It was clear that taxpayers spent well over 750 hours during the year working as an employee of the real estate companies. The provisions of Section 469(c)(7)(D)(ii) indicate that personal services performed by an employee shall not be treated as performed in real estate trades or businesses. However, if the taxpayer owns more than five percent of the entity for which he is an employee then the hours can be counted. In this case it was found that the taxpayer did not show that he dedicated in excess of 750 hours per year toward the management of his personal real estate portfolio and therefore was denied a deduction for the losses incurred on the rental real estate.

1.02 In *Mohammad M. Zarrinnegar and Mary M. Dini v. Commissioner*, 113 T.C.M. 1148, the taxpayers were again attempting to deduct losses incurred in connection with rental real estate. In this case, both taxpayers were dentists who shared a staggered dental practice. The government contended that the taxpayers were not real estate professionals and did not spend the requisite hours in connection with their real estate rental activity and also kept inadequate records of charges for supplies and how they are related to their dental practice. Petitioner husband worked at real estate brokerage activities in additional to his dental practice. He spent hundreds of hours on brokerage related activities including brokers' tours, listing searches, open houses, property viewing and client meetings. It was clear that petitioner spent more than 1,000 hours on the real estate business. In determining the number of hours husband spent in the real estate activities, the Court noted that contemporaneous time reports, logs, or similar documents are not required. The number of hours can be shown by reasonable means which can include the identification of the services performed over a period of time and the approximate number of hours performing such services during such period based upon appointment books, calendars and narrative summaries. A post-event ballpark guesstimate is not sufficient but neither is a contemporaneous time log required. The Court's finding was that the Petitioner worked more hours on his real estate activities than he did on his dental practice and thus qualified as a real estate professional and thus losses on his rental real estate activities were allowed. However, Taxpayers were penalized for keeping insufficient records concerning expense deductions related to their dental practice.

1.03 In Revenue Procedure 2017-3, Internal Revenue Service was discussing additional matters which were to be added to their no ruling area. One of the areas involved the tax consequences of shared appreciation mortgage loans in which a taxpayer borrowing money to purchase real property pays a fixed rate of interest on the mortgage loan below the prevailing market rate and will also pay the lender a percentage of the appreciation value of the real property upon termination of the mortgage. The Service said that this would be a no ruling area if the facts are not similar to those described in Revenue Ruling 83-51. This revenue ruling describes three separate situations where money was advanced to a taxpayer under a shared appreciation mortgage arrangement. In each case, the loan bore current interest plus some share of the appreciation payable at the time the property was transferred or the loan paid off. In one of the transactions, the taxpayer had the shared appreciation mortgage for the full term of the shared appreciation loan and at the end of that loan the taxpayer refinanced the loan and paid a percentage of the appreciation to the shared appreciation mortgage loan holder. In this situation, the taxpayer was not allowed to deduct the contingent interest on the shared appreciation mortgage loan because pursuant to the refinancing, the loan was not deemed "paid" and thus the contingent interest was not deductible. In the other two instances the property was transferred or the loan was paid off. In order to reach a position consistent with rulings issued by the Internal Revenue Service on a shared appreciation mortgage loan in order for the contingent interest to be considered deductible under Section 163, the loan must be "paid" at the termination of the shared appreciation mortgage.