



ACTIVE PARTICIPATION STRATEGY GUIDE

How to deduct up to \$25,000 of rental losses against ordinary income without qualifying as a real estate professional



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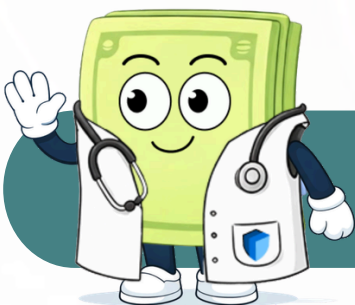
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Executive Summary

Under IRC §469(i), rental real estate is generally treated as a passive activity, meaning losses can only offset passive income. However, the Active Participation exception provides limited but valuable relief.

If you own at least 10% of a rental property and participate in meaningful management decisions, you may be able to deduct up to \$25,000 of rental losses annually against non-passive income, such as W-2 wages or business income. This deduction is subject to income limitations and phases out as modified adjusted gross income (MAGI) increases.

This guide explains who qualifies, how the income phase-out works, what documentation is required, and how to integrate Active Participation into a broader rental tax strategy.



I'm Doc, here to guide you along the way and show you how TaxMD™ can help put these strategies into action.

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Who This Guide Is For

This guide is designed for:

- Individual rental property owners
- Small landlords managing their own residential or commercial rentals
- Taxpayers with moderate income who do not qualify as Real Estate Professionals
- Investors seeking to offset W-2 or business income with rental losses

This rule is particularly relevant for early-stage investors building portfolios who are not yet full-time real estate operators.

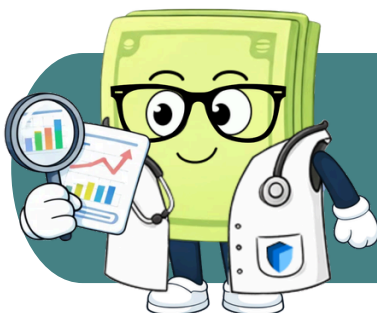
What Is Active Participation

Active Participation is a special exception under IRC §469(i) that allows qualifying taxpayers to deduct a portion of rental real estate losses against non-passive income.

Unlike Real Estate Professional Status (REPS), Active Participation:

- Does not require 750 hours
- Does not require that real estate be your primary occupation
- Does not require material participation under the stricter seven tests

Instead, it requires ownership plus meaningful involvement in management decisions.



TaxMD™ can show you how Active Participation applies to your real numbers and provide personalized guidance on structuring your ownership and involvement to potentially qualify and unlock rental loss deductions.

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Qualification Requirements

To qualify for Active Participation:

1. Ownership Requirement

You must own **at least 10%** of the rental property.

2. Management Involvement

You must participate in significant and bona fide management decisions, such as:

- Approving tenants
- Setting rental terms
- Authorizing major repairs or improvements
- Establishing rental policies

You are not required to handle day-to-day operations or log a minimum number of hours.

3. Rental Activity Only

The rule applies to traditional rental real estate activities, including residential and commercial property.

It does not apply to:

- Short-term rentals with average stays of 7 days or less
- Rentals averaging 30 days or less where significant personal services are provided
- Lodging activities treated as businesses

\$25,000 Loss Allowance

If you qualify, you may deduct up to \$25,000 per year of rental losses against non-passive income.

Income Limits

- Full \$25,000 deduction available when MAGI is \$100,000 or less
- Phases out between \$100,000 and \$150,000 MAGI
- Eliminated at \$150,000 or more MAGI

For married filing separately:

- Full deduction available at \$50,000 or less
- Phases out between \$50,000 and \$75,000

Losses disallowed due to income limits are suspended and carried forward to future years.



Login to TaxMD™ to see how this allowance looks with your real income and losses.

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Example Scenario

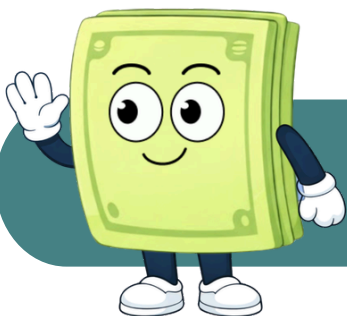
A taxpayer earns \$90,000 in W-2 income and owns a rental property that generates a \$20,000 loss due to depreciation and expenses.

Because their MAGI is below \$100,000 and they actively participate:

- The full \$20,000 loss can offset W-2 income
- Taxable income is reduced from \$90,000 to \$70,000
- Immediate tax savings result based on their marginal rate

If the same taxpayer had MAGI of \$140,000:

- The deduction would be partially phased out
- A portion of the loss would be suspended and carried forward



Login to TaxMD™ to see if your MAGI is low enough for you to participate actively and have rental losses fully offset W-2 income.

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How This Applies to You

Active Participation is particularly useful if:

- You are a W-2 employee building rental properties on the side
- You do not qualify for Real Estate Professional Status
- Your income is below or near the \$150,000 threshold
- You want limited but immediate relief from rental losses

This strategy is often overlooked because investors assume all rental losses are passive. For moderate-income taxpayers, this exception can produce meaningful annual savings.



You can see those potential annual savings in your workspace on TaxMD™

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Key Risks and Documentation

Income Phase-Out Risk

If your MAGI approaches \$150,000, the benefit declines significantly. Planning becomes critical near the threshold.

Documentation Risk

You must be able to demonstrate management involvement. This may include:

- Emails approving tenants
- Lease agreements you signed
- Repair authorizations
- Property management communications

Audit Scrutiny

Although the threshold for participation is lower than REPS, the IRS may review whether your involvement was legitimate and substantial.

Suspended Loss Build-Up

If your income exceeds limits, losses accumulate as suspended passive losses and may only be used later.

Assumptions

- You own at least 10% of the property
- You participate in meaningful management decisions
- Your rental activity qualifies under IRS definitions
- Your MAGI falls within allowable limits for full or partial deduction

Strategic Considerations

Timing of Repairs and Expenses

If you qualify for the \$25,000 deduction, properly timing ordinary and necessary repairs may maximize current-year benefit while complying with tangible property regulations.

Income Planning

If your MAGI is near the phase-out range, consider:

- Retirement contributions
- Income deferral strategies
- Coordinating bonus income timing

Lowering MAGI may preserve more of the \$25,000 allowance.

Entity Structuring

Ownership through an LLC does not eliminate eligibility, but ownership percentage and management authority must be clear.



TaxMD™ helps you see how the timing of repairs, income planning, and ownership structure can maximize your Active Participation deduction and ensure you stay within IRS rules.

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Next Step Checklist

Immediate (Next 7 Days)

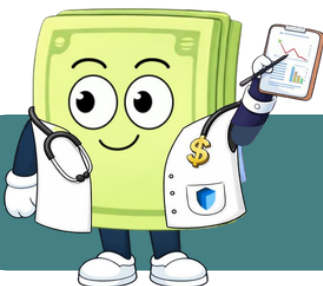
- Confirm ownership percentage
- Review management involvement
- Gather rental income and expense documentation

Implementation (Days 8–30)

- Track rental income and expenses
- Monitor MAGI projection
- Document management decisions

Ongoing (Monthly)

- Maintain records of participation
- Monitor income thresholds
- Coordinate with your CPA to ensure proper reporting



Need a detailed tracker? Login to your TMD™ workspace to track your progress, and see the tax savings from each strategy.

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Tax Engine



#AVATAR 2
Business Owner



Entity Structuring



#AVATAR 1
Real State Investor



#AVATAR 5
Retiree



#AVATAR 6
W-2 Employee



#AVATAR 3
Side Hustler



Event Driven Planning



How TaxMD™ Helps You Use Active Participation Strategically

TaxMD™ allows you to:

- Project MAGI to determine full or partial eligibility
- Model rental losses against other income
- Track suspended passive losses
- Compare Active Participation versus REPS strategy
- Identify whether income reduction planning preserves the deduction


Active Participation is not a replacement for full Real Estate Professional Status, but for moderate-income investors, it can be a powerful and often underutilized tool.



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