

REAL ESTATE



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Q What are the tax implications for loaning money to a family real estate partnership?

A Under the passive activities rules, losses and deductions from passive activities cannot offset unrelated portfolio income and income from other passive activities. When an owner lends money to a related pass-through entity for use in a passive activity, self-charged interest income is treated as portfolio income and cannot be offset by the related interest expense. An election can be made to recharacterize some or all of the self-charged interest income as passive, rather than portfolio income. This allows interest income to be offset by the taxpayer's passive activity deductions attributable to the related interest expense. The self-charged interest rules apply to owner/entity loans when the taxpayer owns any direct or indirect interest in the pass-through entity. Keep in mind that only the applicable percentage of the owner's self-charged interest income and pass-through income are offset. The rules also apply to loans between pass-through entities if each owner of the borrowing entity has the same proportionate ownership interest in the lending entity. Interest includes guaranteed payments for the use of capital and includes foregone interest attributable to below-market loan rules. Interest paid on money borrowed from a third party and subsequently loaned to a related pass-through entity that is usually investment interest expense, can also be recharacterized as passive.