

section 469, S corporations, partnerships, or sole proprietorships. The Commissioner may assert penalties under section 6662 against the taxpayers in appropriate circumstances.

(g) *Treatment of partial dispositions.* A taxpayer may, for the taxable year in which there is a disposition of substantially all of an activity, treat the part disposed of as a separate activity, but only if the taxpayer can establish with reasonable certainty—

(1) The amount of deductions and credits allocable to that part of the activity for the taxable year under § 1.469-1(f)(4) (relating to carryover of disallowed deductions and credits); and

(2) The amount of gross income and of any other deductions and credits allocable to that part of the activity for the taxable year.

(h) *Rules for grouping rental real estate activities for taxpayers qualifying under section 469(c)(7).* See § 1.469-9 for rules for certain rental real estate activities.

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§ 1.469-4T Definition of activity (temporary).

(a) *Overview—(1) Purpose and effect of overview.* This paragraph (a) contains a general description of the rules contained in this section and is intended solely as an aid to readers. The provisions of this paragraph (a) are not a substitute for the more detailed rules contained in the remainder of this section and cannot be relied upon in cases in which those rules qualify the general description contained in this paragraph (a).

(2) *Scope and structure of § 1.469-4T.* This section provides rules under which a taxpayer's business and rental operations are treated as one or more activities for purposes of section 469 and the regulations thereunder. (See paragraph (b)(2)(ii) of this section for the definition of business and rental operations.) In general, these rules are divided into three groups:

(i) Rules that identify the business and rental operations that constitute an undertaking (the undertaking rules).

(ii) Rules that identify the undertaking or undertakings that constitute an activity (the activity rules).

(iii) Rules that apply only under certain special circumstances (the special rules).

(3) *Undertaking rules—(i) In general.* The undertaking is generally the smallest unit that can constitute an activity. (See paragraph (b)(1) of this section for the general rule and paragraph (k)(2)(iii) of this section for a special rule that permits taxpayers to treat a single rental real estate undertaking as multiple activities.) An undertaking may include diverse business and rental operations.

(ii) *Basic undertaking rule.* The basic undertaking rule identifies the business and rental operations that constitute an undertaking by reference to their location and ownership. Under this rule, business and rental operations that are conducted at the same location and are owned by the same person are generally treated as part of the same undertaking. Conversely, business and rental operations generally constitute separate undertakings to the extent that they are conducted at different locations or are not owned by the same person. (See paragraph (c)(2)(i) of this section.)

(iii) *Circumstances in which location is disregarded.* In some circumstances, the undertaking in which business and rental operations are included does not depend on the location at which the operations are conducted. Operations that are not conducted at any fixed place of business or that are conducted at the customer's place of business are treated as part of the undertaking with which the operations are most closely associated (see paragraph (c)(2)(iii)(C) of this section). In addition, operations that are conducted at a location but do not relate to the production of property at that location or to the transaction of business with customers at that location are treated, in effect, as part of the undertaking or undertakings that the operations support (see paragraph (c)(2)(ii) of this section).

(iv) *Rental undertakings.* The basic undertaking rule is also modified if the undertaking determined under that rule includes both rental and nonrental operations. In such cases, the rental operations and the nonrental operations generally must be treated as separate undertakings (see paragraph

(d)(1) of this section). This rule does not apply if more than 80 percent of the income of the undertaking determined under the basic rule is attributable to one class of operations (*i.e.*, rental or nonrental) or if the rental operations would not be treated as part of a rental activity because of the exceptions contained in § 1.469-1T(e)(3)(ii) (see paragraph (d)(2) of this section). In applying the rental undertaking rules, short-term rentals of real property (*e.g.*, hotel-room rentals) are generally treated as nonrental operations (see paragraph (d)(3)(ii) of this section).

(v) *Oil and gas wells.* Another exception to the basic undertaking rule treats oil and gas wells that are subject to the working-interest exception in § 1.469-1T(e)(4) as separate undertakings (see paragraph (e) of this section).

(4) *Activity rules*—(i) *In general.* The basic activity rule treats each undertaking in which a taxpayer owns an interest as a separate activity of the taxpayer (see paragraph (b)(1) of this section). In the case of trade or business undertakings, professional service undertakings, and rental real estate undertakings, additional rules may either require or permit the aggregation of two or more undertakings into a single activity.

(ii) *Aggregation of trade or business undertakings*—(A) *Trade or business undertakings.* Trade or business undertakings include all nonrental undertakings other than oil and gas undertakings described in paragraph (a)(3)(v) of this section and professional service undertakings described in paragraph (a)(4)(iii) of this section (see paragraph (f)(1)(ii) of this section).

(B) *Similar, commonly-controlled undertakings treated as a single activity.* An aggregation rule treats trade or business undertakings that are both similar and controlled by the same interests as part of the same activity. This rule is, however, generally inapplicable to small interests held by passive investors in such undertakings, except to the extent such interests are held through the same passthrough entity. (See paragraph (f)(2) of this section.) Undertakings are similar for purposes of this rule if more than half (by value) of their operations are in the same line of business (as defined in a revenue pro-

cedure issued pursuant to paragraph (f)(4)(iv) of this section) or if the undertakings are vertically integrated (see paragraph (f)(4)(iii) of this section). All the facts and circumstances are taken into account in determining whether undertakings are controlled by the same interests for purposes of the aggregation rule (see paragraph (j)(1) of this section). If, however, each member of a group of five or fewer persons owns a substantial interest in each of the undertakings, the undertakings may be rebuttably presumed to be controlled by the same interests (see paragraph (j)(2) and (3) of this section).

(C) *Integrated businesses treated as a single activity.* Trade or business undertakings (including undertakings that have been aggregated because of their similarity and common control) are subject to a second aggregation rule. Under this rule undertakings that constitute an integrated business and are controlled by the same interests must be treated as part of the same activity. (See paragraph (g) of this section.)

(iii) *Aggregation of professional service undertakings.* Professional service undertakings are nonrental undertakings that predominantly involve the provision of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting (see paragraph (h)(1)(ii) of this section). In general, professional service undertakings that are either similar, related, or controlled by the same interests must be treated as part of the same activity (see paragraph (h)(2) of this section). The rules for determining whether trade or business undertakings are controlled by the same interests also apply with respect to professional service undertakings. Professional service undertakings are similar, however, if more than 20 percent (by value) of their operations are in the same field, and two professional service undertakings are related if one of the undertakings derives more than 20 percent of its gross income from persons who are customers of the other undertaking (see paragraph (h)(3) of this section).

(iv) *Rules for rental real estate*—(A) *Taxpayers permitted to determine rental real estate activities.* The rules for aggregating rental real estate undertakings

are generally elective. They permit taxpayers to treat any combination of rental real estate undertakings as a single activity. Taxpayers may also divide their rental real estate undertakings and then treat portions of the undertakings as separate activities or recombine the portions into activities that include parts of different undertakings. (See paragraph (k)(2) (i) and (iii) of this section.)

(B) *Limitations on fragmentation and aggregation of rental real estate.* Taxpayers may not fragment their rental real estate in a manner that is inconsistent with their treatment of such property in prior taxable years or with the treatment of such property by the passthrough entity through which it is held (see paragraph (k) (2)(ii) and (3) of this section). There are no comparable limitations on the aggregation of rental real estate into a single activity. If however, the income or gain from a rental real estate undertaking is subject to recharacterization under § 1.469-2T(f)(3) (relating to the rental of non-depreciable property), a coordination rule provides that the undertaking must be treated as a separate activity (see paragraph (k)(6) of this section.)

(v) *Election to treat nonrental undertakings as separate activities.* Another elective rule permits taxpayers to treat a nonrental undertaking as a separate activity even if the undertaking would be treated as part of a larger activity under the aggregation rules applicable to the undertaking (see paragraph (o)(2) of this section). This elective rule is limited by consistency requirements similar to those that apply to rental real estate operations (see paragraph (o) (3) and (4) of this section). Moreover, in cases in which a taxpayer elects to treat a nonrental undertaking as a separate activity, the taxpayer's level of participation (*i.e.*, material, significant, or otherwise) in the separate activity is the same as the taxpayer's level of participation in the larger activity in which the undertaking would be included but for the election (see paragraph (o)(6) of this section).

(5) *Special rules*—(i) *Consolidated groups and publicly traded partnerships.* Special rules apply to the business and rental operations of consolidated

groups of corporations and publicly traded partnerships. Under these rules, a consolidated group is treated as one taxpayer in determining its activities and those of its members (see paragraph (m) of this section), and business and rental operations owned through a publicly traded partnership cannot be aggregated with operations that are not owned through the partnership (see paragraph (n) of this section).

(ii) *Transitional rule.* A special rule applies for taxable years ending before August 10, 1989. In those years, taxpayers may organize business and rental operations into activities under any reasonable method (see paragraph (p)(1) of this section). A taxpayer will also be permitted to use any reasonable method to allocate disallowed deductions and credits among activities for the first taxable year in which the taxpayer's activities are determined under the general rules of § 1.469-4T (see paragraph (p)(3) of this section).

(b) *General rule and definitions of general application*—(1) *General rule.* Except as otherwise provided in this section, each undertaking in which a taxpayer owns an interest shall be treated as a separate activity of the taxpayer. See paragraphs (f), (g), and (h) of this section for rules requiring certain nonrental undertakings to be treated as part of the same activity and paragraph (k) of this section for rules identifying the rental real estate undertakings (or portions thereof) that are included in an activity.

(2) *Definitions of general application.* The following definitions set forth the meaning of certain terms for purposes of this section:

(i) *Passthrough entity.* The term “passthrough entity” means a partnership, S corporation, estate, or trust.

(ii) *Business and rental operations*—(A) *In general.* Except as provided in paragraph (b)(2)(ii)(B) of this section, the term “business and rental operations” means all endeavors that are engaged in for profit or the production of income and satisfy one or more of the following conditions for the taxable year:

(I) Such endeavors involve the conduct of a trade or business (within the

meaning of section 162) or are conducted in anticipation of such endeavors becoming a trade or business;

(2) Such endeavors involve making tangible property available for use by customers; or

(3) Research or experimental expenditures paid or incurred with respect to such endeavors are deductible under section 174 (or would be deductible if the taxpayer adopted the method described in section 174(a)).

(B) *Operations conducted through non-passthrough entities.* For purposes of applying section 469 and the regulations thereunder, a taxpayer's activities do not include operations that a taxpayer conducts through one or more entities (other than passthrough entities). The following example illustrates the operation of this paragraph (b)(2)(ii)(B):

Example. (i) A, an individual, owns stock of X, a closely held corporation (within the meaning of § 1.469-1T(g)(2)(ii) that is directly engaged in the conduct of a real estate development business. A participates in X's real estate development business, but does not own any interest in the business other than through ownership of the stock of X.

(ii) X is subject to section 469 (see § 1.469-1T(b)(5)) and does not hold the real estate development business through another entity. Accordingly, for purposes of section 469 and the regulations thereunder, the operations of X's real estate development business are treated as part of X's activities.

(iii) A is also subject to section 469 (see § 1.469-1T(b)(1)), but A's only interest in the real estate development business is held through X. X is a C corporation and therefore is not a passthrough entity. Thus, for purposes of section 469 and the regulations thereunder, A's activities do not include the operations of X's real estate development business. Accordingly, A's participation in X's business is not participation in an activity of A, and is not taken into account in determining whether A materially participates (within the meaning of § 1.469-5T) or significantly participates (within the meaning of § 1.469-1T(c)(2)) in any activity. (See, however, § 1.469-1T(g)(3) for rules under which a shareholder's participation is taken into account for purposes of determining whether a corporation materially or significantly participates in an activity.

(c) *Undertaking*—(1) *In general.* Except as otherwise provided in paragraphs (d), (e), and (k)(2)(iii) of this section, business and rental operations that constitute a separate source of income production shall be treated as a single

undertaking that is separate from other undertakings.

(2) *Operations treated as a separate source of income production*—(i) *In general.* Except as otherwise provided in this paragraph (c)(2), business and rental operations shall be treated for purposes of this paragraph (c) as a separate source of income production if and only if—

(A) Such operations are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (within the meaning of paragraph (c)(2)(v) of this section); and

(B) Income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) owned by such person are conducted at such location.

(ii) *Treatment of support operations*—

(A) *In general.* For purposes of section 469 and the regulations thereunder—

(1) The support operations conducted at a location shall not be treated as part of an undertaking under paragraph (c)(2)(i) of this section; and

(2) The income and expenses that are attributable to such operations and are reasonably allocable to an undertaking conducted at a different location shall be taken into account in determining the income or loss from the activity or activities that include such undertaking.

(B) *Support operations.* For purposes of this paragraph (c)(2), the business and rental operations conducted at a location are treated as support operations to the extent that—

(1) Such operations and an undertaking that is conducted at a different location are owned by the same person (within the meaning of paragraph (c)(2)(v) of this section);

(2) Such operations involve the provision of property or services to such undertaking; and

(3) Such operations are not income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section).

(iii) *Location.* For purposes of this paragraph (c)(2)—

(A) The term “location” means, with respect to any business and rental operations, a fixed place of business at which such operations are regularly conducted;

(B) Business and rental operations are conducted at the same location if they are conducted in the same physical structure or within close proximity of one another;

(C) Business and rental operations that are not conducted at a fixed place of business or that are conducted on the customer's premises shall be treated as operations that are conducted at the location (other than the customer's premises) with which they are most closely associated;

(D) All the facts and circumstances (including, in particular, the factors listed in paragraph (c)(3) of this section) are taken into account in determining the location with which business and rental operations are most closely associated; and

(E) Oil and gas operations that are conducted for the development of a common reservoir are conducted within close proximity of one another.

(iv) *Income-producing operations.* For purposes of this paragraph (c)(2), the term "income-producing operations" means business and rental operations that are conducted at a location and relate to (or are conducted in reasonable anticipation of)—

(A) The production of property at such location;

(B) The sale of property to customers at such location;

(C) The performance of services for customers at such location;

(D) Transactions in which customers take physical possession at such location of property that is made available for their use; or

(E) Any other transactions that involve the presence of customers at such location.

(v) *Ownership by the same person.* For purposes of this paragraph (c)(2), business and rental operations are owned by the same person if and only if one person (within the meaning of section 7701(a)(1)) is the direct owner of such operations.

(3) *Facts and circumstances determinations.* In determining whether a location is the location with which business and rental operations are most closely associated for purposes of paragraph (c)(2)(iii)(D) of this section, the following relationships between operations that are conducted at such loca-

tion and other operations are generally the most significant:

(i) The extent to which other persons conduct similar operations at one location;

(ii) Whether such operations are treated as a unit in the primary accounting records reflecting the results of such operations;

(iii) The extent to which other persons treat similar operations as a unit in the primary accounting records reflecting the results of such similar operations;

(iv) The extent to which such operations involve products or services that are commonly provided together;

(v) The extent to which such operations serve the same customers;

(vi) The extent to which the same personnel, facilities, or equipment are used to conduct such operations;

(vii) The extent to which such operations are conducted in coordination with or reliance upon each other;

(viii) The extent to which the conduct of any such operations is incidental to the conduct of the remainder of such operations;

(ix) The extent to which such operations depend on each other for their economic success; and

(x) Whether such operations are conducted under the same trade name.

(4) *Examples.* The following examples illustrate the application of this paragraph (c). In each example that does not state otherwise, the taxpayer is an individual and the facts, analysis, and conclusion relate to a single taxable year.

Example 1. The taxpayer is the sole owner of a department store and a restaurant and conducts both businesses in the same building. Thus, the department store and restaurant operations are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). In addition, the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the location (*i.e.*, property is sold to customers and services are performed for customers on the premises of the department store). Accordingly, the department store and restaurant operations are treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking

that is separate from other undertakings (see paragraph (c)(1) of this section).

Example 2. (i) The facts are the same as in Example 1, except that the taxpayer is also the sole owner of an automotive center that services automobiles and sells tires, batteries, motor oil, and accessories. The taxpayer operates the automotive center in a separate structure in the shopping mall in which the department store is located. Although the automotive center operations and the department store and restaurant operations are not conducted in the same physical structure, they are conducted within close proximity (within the meaning of paragraph (c)(2)(iii)(B) of this section) of one another. Thus, the department store, restaurant, and automotive center operations are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section).

(ii) As in Example 1, the operations conducted at the same location are owned by the same person, and the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the location. Accordingly, the department store, restaurant, and automotive center operations are treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking that is separate from other undertakings (see paragraph (c)(1) of this section).

Example 3. (i) The facts are the same as in Example 2, except that the automotive center is located several blocks from the shopping mall. As in Example 1, the department store and restaurant operations are treating as a single undertaking that is separate from other undertakings. Because, however, the automotive center operations are not conducted within close proximity (within the meaning of paragraph (c)(2)(iii)(B) of this section) of the department store and restaurant operations, all of the taxpayer's operations are not conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section).

(ii) All of the automotive center operations are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). In addition, the taxpayer conducts income producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the location (*i.e.*, property is sold to customers and services are performed for customers on the premises of the automotive center). Accordingly, the automotive center operations are also treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking that is separate from other undertakings (see paragraph (c)(1) of this section). See, however, paragraph (g) of this section for rules under which certain trade or busi-

ness activities are treated as a single activity.

Example 4. The taxpayer is the sole owner of a building and rents residential, office, and retail space in the building to various tenants. The taxpayer manages these rental operations from an office located in the building. The rental operations are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). In addition, the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the location (*i.e.*, customers take physical possession in the building of property made available for their use). Accordingly, the rental operations are treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking that is separate from other undertakings (see paragraph (c)(1) of this section). See paragraph (d) of this section for rules for determining whether this undertaking is a rental undertaking and paragraph (k) of this section for rules for identifying rental real estate activities.

Example 5. (i) The facts are the same as in Example 4, except that the taxpayer also uses the rental office in the building ("Building #1") to manage rental operations in another building ("Building #2") that the taxpayer owns. The rental operations conducted in Building #2 are treated as a separate source of income production under paragraph (c)(2) of this section and as a single undertaking that is separate from other undertakings (the "Building #2 undertaking") under paragraph (c)(1) of this section.

(ii) The operations conducted at the rental office in Building #1 and the Building #2 undertaking are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). In addition, the operations conducted at the rental office with respect to the Building #2 undertaking relate to transactions in which customers take physical possession at another location of property that is made available for their use (*i.e.*, the operations are not income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section)). Thus, to the extent the operations conducted at the rental office involve the management of the Building #2 undertaking, they are support operations (within the meaning of paragraph (c)(2)(ii)(B) of this section) with respect to the Building #2 undertaking.

(iii) Paragraph (c)(2)(ii)(A)(I) of this section provides that support operations are not treated as part of an undertaking under paragraph (c)(2)(i) of this section. Therefore, the support operations conducted at the rental office are not treated as part of the

undertaking that consists of the rental operations conducted in Building #1 (the “Building #1 undertaking”). Paragraph (c)(2)(ii)(A)(2) of this section provides that the income and expenses that are attributable to support operations and are reasonably allocable to an undertaking conducted at a different location shall be taken into account in determining the income or loss from the activity that includes such undertaking. Accordingly, the income and expenses of the rental office that are reasonably allocable to the Building #2 undertaking are taken into account in determining the income or loss from the activity or activities that include the Building #2 undertaking. See paragraph (k) of this section for rules for identifying rental real estate activities.

(iv) Rental office operations that involve the management of rental operations conducted in Building #1 are not support operations (within the meaning of paragraph (c)(2)(ii)(B) of this section) because they relate to an undertaking that is conducted at the same location (the “Building #1 undertaking”). Thus, the rules for support operations in paragraph (c)(2)(ii)(A) of this section do not apply to such operations, and they are treated as part of the Building #1 undertaking.

Example 6. (i) The taxpayer conducts business and rental operations at eleven different locations (within the meaning of paragraph (c)(2)(iii) of this section). At ten of the locations the taxpayer owns grocery stores, and at the eleventh location the taxpayer owns a warehouse that receives goods and supplies them to the taxpayer’s stores. The operations of each store are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). In addition, the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at each location (*i.e.*, property is sold to customers on the store premises, and customers take physical possession on the store premises of property made available for their use). Accordingly, the operations of each of the ten grocery stores are treated as a separate source of income production (see paragraph (c)(2) of this section), and each store is treated as a single undertaking (a “grocery store undertaking”) that is separate from other undertakings (see paragraph (c)(1) of this section). The operations conducted at the warehouse, however, do not include any income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section). Accordingly, the warehouse operations do not satisfy the requirements of paragraph (c)(2)(i) of this section and are not treated as a separate undertaking under paragraph (c)(1) of this section.

(ii) The warehouse operations and the grocery store undertakings are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations), the operations conducted at the warehouse involve the provision of property to the grocery store undertakings, and the warehouse operations are not income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section). Thus, the warehouse operations are support operations (within the meaning of paragraph (c)(2)(ii)(B) of this section) with respect to the grocery store undertakings. Paragraph (c)(2)(ii)(A)(2) of this section provides that the income and expenses that are attributable to support operations and are reasonably allocable to an undertaking conducted at a different location shall be taken into account in determining the income or loss from the activity or activities that include such undertaking. Accordingly, the income and expenses of the warehouse operations that are reasonably allocable to a grocery store undertaking are taken into account in determining the income or loss from the activity or activities that include such undertaking. See paragraph (f) of this section for rules under which certain similar, commonly-controlled undertakings are treated as a single activity.

Example 7. (i) The facts are the same as in Example 6, except that the warehouse operations also include the sale of goods to grocery stores that the taxpayer does not own (“other grocery stores”). Because of these sales, the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the warehouse. The warehouse operations are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). Accordingly, prior to the application of the rules for support operations in paragraph (c)(2)(ii) of this section, the warehouse operations are treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking (the “separate warehouse undertaking”) that is separate from other undertakings (see paragraph (c)(1) of this section).

(ii) As in Example 6, the warehouse operations that involve supplying goods to the taxpayer’s grocery store undertakings are support operations with respect to those undertakings. Therefore, those operations are not treated as part of the separate warehouse undertaking (see paragraph (c)(2)(ii)(A)(1) of this section), and the income and expenses of such operations are taken into account, as in Example 6, in determining the income or loss from the activity or activities that include the taxpayer’s grocery store undertakings.

Example 8. (i) A partnership is formed to acquire real property and construct a building on the property. The partnership hires brokers to locate a suitable parcel of land, lawyers to negotiate zoning variances, easements, and building permits, and architects and engineers to design the improvements. After the architects and engineers have designed the improvements and other preliminaries have been completed, the partnership hires a general contractor who hires subcontractors and oversees construction. During the construction process and after construction has been completed, the partnership leases out space in the building. The partnership then operates the building as a rental property. The operations of acquiring the real property, negotiating contracts, overseeing the designing and construction of the improvements, leasing up the building, and operating the building are conducted at an office (the “management office”) that is not at the same location (within the meaning of paragraph (c)(2)(iii) of this section) as the building.

(ii) The operations conducted at the building site (*e.g.*, excavating the land, pouring the concrete for the foundation, erecting the frame of the building, completing the exterior of the building, and building out the interior of the building) are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the partnership is the direct owner of the operations). In addition, the partnership conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the location (*i.e.*, during the construction period property (the building) is produced at the building site, and during the rental period customers take physical possession in the building of property made available for their use). Accordingly, the operations conducted at the building site are treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking that is separate from other undertakings (see paragraph (c)(1) of this section).

(iii) The operations conducted at the management office and the undertaking conducted at the building site are owned by the same person (*i.e.*, the partnership is the direct owner of the operations). In addition, the operations conducted at the management office relate to transactions in which customers take physical possession at another location of property that is made available for their use (*i.e.*, the operations are not income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section)). Thus, to the extent the operations conducted at the management office involve the provision of services to the undertaking conducted at the building site, they are support operations (within the meaning of para-

graph (c)(2)(ii)(B) of this section) with respect to such undertaking.

(iv) Paragraph (c)(2)(ii)(A)(2) of this section provides that the income and expenses of support operations that are reasonably allocable to an undertaking conducted at a different location shall be taken into account in determining the income or loss from the activity that includes such undertaking. Accordingly, the income and expenses of the management office that are reasonably allocable to the undertaking conducted at the building site are taken into account in determining the income or loss from the activity or activities that include such undertaking.

(v) Until the building is first held out for rent and is in a state of readiness for rental, the undertaking conducted at the building site is a trade or business undertaking (within the meaning of paragraph (f)(1)(ii) of this section). See paragraph (d) of this section for rules for determining whether the undertaking is a rental undertaking for periods after the building is first held out for rent and is in a state of readiness for rental and paragraph (k) of this section for rules for identifying rental real estate activities.

Example 9. The taxpayer owns 15 oil wells pursuant to a single working interest (within the meaning of § 1.469-1T (e)(4)(iv)). All of the wells are drilled and operated for the development of a common reservoir. Thus, all of the wells are at the same location (see paragraph (c)(2)(iii)(E) of this section). All of the wells are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations), and the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the location (*i.e.*, oil wells are drilled in reasonable anticipation of producing oil at the location). Accordingly, the operations of the wells are treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking that is separate from other undertakings (see paragraph (c)(1) of this section). See paragraph (e) of this section for rules under which certain oil and gas operations are treated as multiple undertakings even if they would be part of the same undertaking under the rules of this paragraph (c).

Example 10. (i) Partnership X owns an automobile dealership and partnership Y owns an automobile repair shop. The dealership and repair shop operations are conducted in the same physical structure. Individuals A, B, and C are the only partners in partnerships X and Y, and each of the partners owns a one-third interest in both partnerships.

(ii) The dealership operations and the repair-shop operations are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section), but are owned by different persons (*i.e.*, X is the direct owner of the dealership operations, and

Y is the direct owner of the repair-shop operations). Moreover, indirect ownership of the operations is not taken into account under paragraph (c)(2)(v) of this section. Thus, it is irrelevant that the two partnerships are owned by the same persons in identical proportions. Accordingly, the dealership and repair-shop operations are not treated as part of the same source of income production (see paragraph (c)(2) of this section) or as a single undertaking that is separate from other undertakings (see paragraph (c)(1) of this section). See, however, paragraph (g) of this section for rules under which certain trade or business activities are treated as a single activity.

Example 11. (i) The taxpayer owns and operates a delivery service. The business consists of a central office, retail establishments, and messengers who transport packages from one place to another. Customers may bring their packages to a retail establishment for delivery elsewhere or, by calling the central office, may have packages picked up at their homes or offices. The central office dispatches messengers and coordinates all pickups and deliveries. Customers may pay for deliveries when they drop off or pick up packages at a retail establishment, or the central office will bill the customer for services rendered. In addition, many packages are routed through the central office.

(ii) The operations conducted at the central office are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). The operations actually conducted at the central office, however, do not include any income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section).

(iii) Under paragraph (c)(2)(iii) (C) and (D) of this section, business and rental operations that are not conducted at a fixed place of business or that are conducted on the customer's premises are treated as operations that are conducted at the location (other than the customer's premises) with which they are most closely associated, and all the facts and circumstances are taken into account in determining the location with which business and rental operations are most closely associated. The facts and circumstances in this case (including the facts that the central office dispatches messengers, coordinates all pickups and deliveries, and is the transshipment point for many packages) establish that the operations of delivering packages from one location to another are most closely associated with the central office. Thus, the delivery operations are treated as operations that are conducted at the central office, and the deliveries are treated as income-producing operations (*i.e.*, the performance of services for customers) that the taxpayer conducts at

the central office. Accordingly, the operations conducted at the central office are treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking that is separate from other undertakings (see paragraph (c)(1) of this section).

(iv) The operations conducted at each retail establishment are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). At each retail establishment, the taxpayer's operations include transactions that involve the presence of customers at the establishment. Thus, the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv)(E) of this section) at the retail establishments. Accordingly, the operations of each retail establishment are treated as a separate source of income production (see paragraph (c)(2) of this section) and as a single undertaking that is separate from other undertakings (see paragraph (c)(1) of this section). See, however, paragraph (f) of this section for rules under which certain similar, commonly-controlled undertakings are treated as a single activity.

Example 12. (i) The taxpayer is the sole owner of a saw mill and a lumber yard. The taxpayer's business operations consist of converting timber into lumber and other wood products and selling the resulting products. The timber is processed at the saw mill, and the resulting products are transported to the lumber yard where they are sold. The saw mill and the lumber yard are at different locations (within the meaning of paragraph (c)(2)(iii) of this section). The transportation operations are managed at the saw mill.

(ii) The operations conducted at the saw mill are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). In addition, the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the location (*i.e.*, lumber is produced at the mill). Similarly, the selling operations at the lumber yard are conducted at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are owned by the same person (*i.e.*, the taxpayer is the direct owner of the operations). In addition, the taxpayer conducts income-producing operations (within the meaning of paragraph (c)(2)(iv) of this section) at the location (*i.e.*, lumber is sold to customers at the lumber yard). Thus, the milling operations and the selling operations are treated as separate sources of income production (see paragraph (c)(2) of this section) and as separate undertakings (see paragraph (c)(1) of this section).

(iii) The operations conducted at the mill involve the provision of property to the lumber-yard undertaking. Nonetheless, the milling operations are income-producing operations because they relate to the production of property at the mill, and an undertaking's income-producing operations are not treated as support operations (see paragraph (c)(2)(ii)(B)(3) of this section). Accordingly, the milling operations are not support operations with respect to the lumber-yard undertaking. See, however, paragraph (f) of this section for rules under which certain vertically-integrated undertakings are treated as part of the same activity.

(iv) The operations of transporting finished products from the saw mill to the lumber yard are not conducted at a fixed location. Under paragraphs (c)(2)(iii) (C) and (D) of this section, business and rental operations that are not conducted at a fixed place of business or that are conducted on the customer's premises are treated as operations that are conducted at the location (other than the customer's premises) with which they are most closely associated, and all the facts and circumstances are taken into account in determining the location with which business and rental operations are most closely associated. The facts and circumstances in this case (including the fact that the transportation operations are managed at the saw mill) establish that the transportation operations are most closely associated with the saw mill. Thus, the transportation operations are treated as operations that are conducted at the mill and as part of the undertaking that consists of the milling operations.

(d) *Rental undertaking*—(1) *In general.* This paragraph (d) applies to operations that are treated, under paragraph (c) of this section and before the application of paragraph (d)(1)(i) of this section, as a single undertaking that is separate from other undertakings (a “paragraph (c) undertaking”). For purposes of this section—

(i) A paragraph (c) undertaking's rental operations and its operations other than rental operations shall be treated, except as otherwise provided in paragraph (d)(2) of this section, as two separate undertakings;

(ii) The income and expenses that are reasonably allocable to an undertaking (determined after the application of paragraph (d)(1)(i) of this section) shall be taken into account in determining the income or loss from the activity or activities that include such undertaking; and

(iii) An undertaking (determined after the application of paragraph (d)(1)(i) of this section) shall be treated as a rental undertaking if and only if such undertaking, considered as a separate activity, would constitute a rental activity (within the meaning of § 1.469-1T(e)(3)).

(2) *Exceptions.* Paragraph (d)(1)(i) of this section shall not apply to a paragraph (c) undertaking for any taxable year in which—

(i) The rental operations of the paragraph (c) undertaking, considered as a separate activity, would not constitute a rental activity (within the meaning of § 1.469-1T(e)(3));

(ii) Less than 20 percent of the gross income of the paragraph (c) undertaking is attributable to rental operations; or

(iii) Less than 20 percent of the gross income of the paragraph (c) undertaking is attributable to operations other than rental operations.

(3) *Rental operations.* For purposes of this paragraph (d), a paragraph (c) undertaking's rental operations are determined under the following rules:

(i) *General rule.* Except as otherwise provided in paragraph (d)(3) (ii) or (iii) of this section, a paragraph (c) undertaking's rental operations are all of the undertaking's business and rental operations that involve making tangible property available for use by customers and the provision of property and services in connection therewith.

(ii) *Real property provided for short-term use.* A paragraph (c) undertaking's operations that involve making short-term real property available for use by customers and the provision of property and services in connection therewith shall not be treated as rental operations if such operations, considered as a separate activity, would not constitute a rental activity. An item of property is treated as short-term real property for this purpose if and only if such item is real property that the paragraph (c) undertaking makes available for use by customers and the average period of customer use (within the meaning of § 1.469-1T(e)(3)(iii)) for all of the paragraph (c) undertaking's real property of the same type as such item is 30 days or less.

(iii) *Property made available to licensees.* A paragraph (c) undertaking's operations that involve making tangible property available during defined business hours for nonexclusive use by various customers shall not be treated as rental operations. (See § 1.469-1T(e)(3)(ii)(E).)

(4) *Examples.* The following examples illustrate the application of this paragraph (d). In each example that does not state otherwise, the taxpayer is an individual and the facts, analysis, and conclusions relate to a single taxable year.

Example 1. (i) The taxpayer owns a building in which the taxpayer rents office space to tenants and operates a parking garage that is used by tenants and other persons. (Assume that, under paragraph (c)(1) of this section, the operations conducted in the building are treated as a single paragraph (c) undertaking.) The taxpayer's tenants typically occupy an office for at least one year, and the services provided to tenants are those customarily provided in office buildings. Some persons (including tenants) rent spaces in the parking garage on a monthly or annual basis. In general, however, spaces are rented on an hourly or daily basis, and the average period for which all customers (including tenants) use the parking garage is less than 24 hours. The paragraph (c) undertaking derives 75 percent of its gross income from office-space rentals and 25 percent of its gross income from the parking garage. The operations conducted in the building are not incidental to any other activity of the taxpayer (within the meaning of § 1.469-1T(e)(3)(vi)).

(ii) The parking spaces are real property and the average period of customer use (within the meaning of § 1.469-1T(e)(3)(iii)) for the parking spaces is 30 days or less. Thus, the parking spaces are short-term real properties (within the meaning of paragraph (d)(3)(ii) of this section). (For this purpose, individual parking spaces that are rented on a monthly or annual basis are, nevertheless, short-term real properties because all the parking spaces are property of the same type, and the average rental period taking all parking spaces into account is 30 days or less.) In addition, the parking-garage operations involve making short-term real properties available for use by customers and the provision of property and services in connection therewith.

(iii) Paragraph (d)(3) (i) and (ii) of this section provides, in effect, that a paragraph (c) undertaking's operations that involve making short-term real properties available for use by customers and the provision of property and services in connection therewith

are treated as rental operations if and only if the operations, considered as a separate activity, would constitute a rental activity (within the meaning of § 1.469-1T(e)(3)). In this case, the parking-garage operations, if considered as a separate activity, would not constitute a rental activity because the average period of customer use for the parking spaces is seven days or less (see § 1.469-1T(e)(3)(ii)(A)). Accordingly, the parking-garage operations are not treated as rental operations.

(iv) The paragraph (c) undertaking's remaining operations involve the provision of tangible property (the office spaces) for use by customers and the provision of property and services in connection therewith. The average period of customer use for the office spaces exceeds 30 days. Thus, the office spaces are not short-term real properties, and the undertaking's operations involving the rental of office spaces are rental operations.

(v) Paragraph (d)(1)(i) of this section provides, with certain exceptions, that a paragraph (c) undertaking's rental operations and its operations other than rental operations are treated as two separate undertakings. In this case, at least 20 percent of the paragraph (c) undertaking's gross income is attributable to rental operations (the office-space operations) and at least 20 percent is attributable to operations other than rental operations (the parking-garage operations). Thus, the exceptions in paragraph (d)(2) (ii) and (iii) of this section do not apply. In addition, the average period of customer use for the office spaces exceeds 30 days, extraordinary personal services (within the meaning of § 1.469-1T(e)(3)(v)) are not provided, and the rental of the office spaces is not treated as incidental to a nonrental activity under § 1.469-1T(e)(3)(vi) (relating to incidental rentals that are not treated as a rental activity). Thus, the rental operations, if considered as a separate activity, would constitute a rental activity, and the exception in paragraph (d)(2)(i) of this section does not apply. Accordingly, the rental operations and the parking-garage operations are treated as two separate undertakings (the "office-space undertaking" and the "parking-garage undertaking").

(vi) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking if and only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the office-space undertaking, if considered as a separate activity, would constitute a rental activity (see (v) above), and the parking-garage undertaking, if considered as a separate activity, would not constitute a rental activity (see (iii)

above). Accordingly, the office-space undertaking is treated as a rental undertaking, and the parking-garage undertaking is not.

Example 2. (i) The taxpayer owns a building in which the taxpayer rents apartments to tenants and operates a restaurant. (Assume that, under paragraph (c)(1) of this section, the operations conducted in the building are treated as a single paragraph (c) undertaking.) The taxpayer's tenants typically occupy an apartment for at least one year, and the services provided to tenants are those customarily provided in residential apartment buildings. The paragraph (c) undertaking derives 85 percent of its gross income from apartment rentals and 15 percent of its gross income from the restaurant. The operations conducted in the building are not incidental to any other activity of the taxpayer (within the meaning of § 1.469-1T(e)(3)(vi)).

(ii) The operations with respect to apartments (the "apartment operations") involve the provision of tangible property (the apartments) for use by customers and the provision of property and services in connection therewith. In addition, the apartments are not short-term real properties (within the meaning of paragraph (d)(3)(ii) of this section) because the average period of customer use (within the meaning of § 1.469-1T(e)(3)(iii)) for the apartments exceeds 30 days. Accordingly, the apartment operations are rental operations (within the meaning of paragraph (d)(3) of this section). The restaurant operations do not involve the provision of tangible property for use by customers or the provision of property or services in connection therewith. Thus, the restaurant operations are not rental operations.

(iii) Paragraph (d)(1)(i) of this section provides, with certain exceptions, that a paragraph (c) undertaking's rental operations and its operations other than rental operations are treated as two separate undertakings. In this case, however, the exception in paragraph (d)(2)(iii) of this section applies because less than 20 percent of the paragraph (c) undertaking's gross income is attributable to operations other than rental operations (the restaurant operations). Accordingly, the rental operations and the restaurant operations are not treated as two separate undertakings under paragraph (d)(1)(i) of this section.

(iv) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking if and only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the undertaking (determined after the application of paragraph (d)(1)(i) of this section) includes both the apartment operations and the restaurant operations, and the gross income of this undertaking represents amounts paid principally for the use of tangible property (the apart-

ments). Moreover, the average period of customer use for the apartments exceeds 30 days, extraordinary personal services (within the meaning of § 1.469-1T(e)(3)(v)) are not provided, and the rental of the apartments is not treated as incidental to a nonrental activity under § 1.469-1T(e)(3)(vi) (relating to incidental rentals that are not treated as a rental activity). Thus, the undertaking, if considered as a separate activity, would constitute a rental activity. Accordingly, the undertaking is treated as a rental undertaking.

Example 3. (i) The taxpayer owns a building in which the taxpayer rents hotel rooms, meeting rooms, and parking spaces to customers, rents space to various retailers, and operates a restaurant and health club. (Assume that, under paragraph (c)(1) of this section, the operations conducted in the building are treated as a single paragraph (c) undertaking.) Although some customers occupy hotel rooms for extended periods (including some customers who reside in the hotel), customers use hotel rooms for an average period of two days and meeting rooms for an average period of one day. The services provided to persons using the hotel rooms and meeting rooms are those customarily provided in hotels (including wake-up calls, valet services, and delivery of food and beverages to rooms). Some customers rent spaces in the parking garage on a monthly or annual basis. In general, however, parking spaces are rented on an hourly or daily basis, and the average period for which customers use the parking garage is less than 24 hours. Retail tenants typically occupy their space for at least one year, and the services provided to retail tenants are those customarily provided in commercial buildings. The paragraph (c) undertaking derives 45 percent of its gross income from renting hotel rooms, meeting rooms, and parking spaces, 35 percent of its gross income from renting retail space, and 20 percent of its gross income from the restaurant and health club. The operations conducted in the building are not incidental to any other activity of the taxpayer (within the meaning of § 1.469-1T(e)(3)(vi)).

(ii) The parking spaces, hotel rooms, and meeting rooms are real property of three different types, but the average period of customer use (within the meaning of § 1.469-1T(e)(3)(iii)) for property of each type is 30 days or less. Thus, the parking spaces, hotel rooms, and meeting rooms are short-term real properties. (For this purpose, individual parking spaces or hotel rooms that are rented for extended periods are, nevertheless, short-term real properties if the average rental period for all parking spaces is 30 days or less and the average rental period for all hotel rooms is 30 days or less.) In addition, the parking garage operations, the operations with respect to hotel rooms (the

“hotel-room operations”), and the operations with respect to meeting rooms (the “meeting-room operations”) involve making short-term real properties available for use by customers and the provision of property and services in connection therewith.

(iii) Paragraph (d)(3) (i) and (ii) of this section provides, in effect, that a paragraph (c) undertaking’s operations that involve making short-term real properties available for use by customers and the provision of property and services in connection therewith are treated as rental operations if and only if the operations, considered as a separate activity, would constitute a rental activity (within the meaning of § 1.469-1T (e)(3)). In this case the parking-garage, hotel-room and meeting-room operations, if considered as separate activities, would not constitute rental activities because the average period of customer use for parking spaces, hotel rooms, and meeting rooms does not exceed seven days (see § 1.469-1T (e)(3)(ii)(A)). Accordingly, the parking-garage, hotel-room, and meeting-room operations are not treated as rental operations.

(iv) The operations with respect to retail space in the building (the “retail-space operations”) involve the provision of tangible property (the retail spaces) for use by customers and the provision of property and services in connection therewith. In addition, the retail spaces are not short-term real properties (within the meaning of paragraph (d)(3)(ii) of this section) because the average period of customer use (within the meaning of § 1.469-1T (e)(3)(iii)) for the retail spaces exceeds 30 days. Accordingly, the retail-space operations are rental operations.

(v) The health-club operations involve making tangible property available for use by customers, but the property is customarily made available during defined business hours for nonexclusive use by various customers. Accordingly, the health-club operations are not rental operations (see paragraph (d)(3)(iii) of this section). The restaurant operations do not involve the provision of tangible property for use by customers or the provision of property or services in connection therewith. Accordingly, the restaurant operations also are not rental operations.

(vi) Paragraph (d)(1)(i) of this section provides, with certain exceptions, that a paragraph (c) undertaking’s rental operations and its operations other than rental operations are treated as two separate undertakings. In this case, at least 20 percent of the paragraph (c) undertaking’s gross income is attributable to rental operations (35 percent of the paragraph (c) undertaking’s gross income is from the retail-space operations) and at least 20 percent is attributable to operations other than rental operations (45 percent from the hotel-room, meeting-room and parking-garage operations and 20 percent

from the restaurant and health-club operations). Thus, the exceptions in paragraph (d)(2) (ii) and (iii) of this section do not apply. In addition, the average period of customer use for the retail space exceeds 30 days, extraordinary personal services (within the meaning of § 1.469-1T (e)(3)(v)) are not provided, and the rental of the retail space is not treated as incidental to a nonrental activity under § 1.469-1T (e)(3)(vi) (relating to incidental rentals that are not treated as a rental activity). Thus, the retail-space operations, if considered as a separate activity, would constitute a rental activity, and the exception in paragraph (d)(2)(i) of this section does not apply. Accordingly, the retail-space operations are treated as an undertaking (the “retail-space undertaking”) and all the other operations conducted in the building (*i.e.*, renting hotel and meeting rooms and parking spaces and operating the restaurant and health club) are treated as a separate undertaking (the “hotel undertaking”).

(vii) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking if and only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the retail-space undertaking, if considered as a separate activity, would constitute a rental activity (see (iv) above). Accordingly, the retail-space undertaking is treated as a rental undertaking. The hotel undertaking, if considered as a separate activity, would not constitute a rental activity because all tangible property provided for the use of customers in the hotel undertaking is either property for which the average period of customer use is seven days or less (see § 1.469-1T (e)(3)(ii)(A)) or property customarily made available during defined business hours for nonexclusive use by various customers (see § 1.469-1T (e)(3)(ii)(E)). Accordingly, the hotel undertaking is not treated as a rental undertaking.

Example 4. (i) A law partnership owns a ten-story building. The partnership uses eight floors of the building in its law practice and leases two floors to one or more tenants. (Assume that, under paragraph (c)(1) of this section, the operations conducted in the building are treated as a single paragraph (c) undertaking.) Tenants typically occupy space on the two rented floors for at least one year, and the services provided to tenants are those customarily provided in office buildings. The paragraph (c) undertaking derives 90 percent of its gross income from rendering legal services and 10 percent of its gross income from renting space. The operations conducted in the building are not incidental to any other activity of the taxpayer (within the meaning of § 1.469-1T (e)(3)(vi)).

(ii) The operations with respect to the office space leased to tenants (the “office-space operations”) involve the provision of tangible property (the office space) for use by customers and the provision of property and services in connection therewith. In addition, the office spaces are not short-term real properties (within the meaning of paragraph (d)(3)(ii) of this section) because the average period of customer use (within the meaning of § 1.469-1T(e)(3)(iii)) for the office space exceeds 30 days. Accordingly, the office-space operations are rental operations (within the meaning of paragraph (d)(3) of this section).

(iii) The operations that involve the performance of legal services (the “law-practice operations”) do not involve the provision of tangible property for use by customers or the provision of property or services in connection therewith. Accordingly, the law-practice operations are not rental operations.

(iv) Paragraph (d)(1)(i) of this section provides, with certain exceptions, that a paragraph (c) undertaking’s rental operations and its operations other than rental operations are treated as two separate undertakings. In this case, however, the exception in paragraph (d)(2)(ii) of this section applies because less than 20 percent of the paragraph (c) undertaking’s gross income is attributable to rental operations (the office-space operations). Accordingly, the law-practice operations and the office-space operations are not treated as two separate undertakings under paragraph (d)(1)(i) of this section.

(v) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the undertaking (determined after the application of paragraph (d)(1)(i) of this section) includes both the law-practice operations and the office-space operations, and the gross income of this undertaking does not represent amounts paid principally for the use of tangible property. Thus, the undertaking, if considered as a separate activity, would not constitute a rental activity. Accordingly, the undertaking is not treated as a rental undertaking.

Example 5. (i) The facts are the same as in Example 4, except that the building is owned by a separate partnership (the “real estate partnership”), which leases eight floors of the building to the law partnership for use in its law practice and two floors to one or more other tenants. The law partnership and real estate partnership are owned by the same individuals in identical proportions.

(ii) The operations conducted in the building are owned by two different persons (*i.e.*, the law partnership and the real estate part-

nership). (See paragraph (c)(2)(v) of this section.) Thus, the operations conducted in the building are not treated as a single undertaking under paragraph (c)(1) of this section. Instead, each partnership’s share of such operations is treated as a separate paragraph (c) undertaking (the “law-practice undertaking” and the “office-space undertaking”).

(iii) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking if and only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the office-space undertaking, if considered as a separate activity, would constitute a rental activity because all of the undertaking’s gross income (including rents paid by the law partnership) represents amounts paid principally for the use of tangible property (the office space), the average period of customer use for the office space exceeds 30 days, extraordinary personal services (within the meaning of § 1.469-1T(e)(3)(v)) are not provided, and the rental of the office space is not treated as incidental to a nonrental activity under § 1.469-1T(e)(3)(vi) (relating to incidental rentals that are not treated as a rental activity). Accordingly, the office-space undertaking is treated as a rental undertaking. See, however, § 1.469-2T(f)(6) (relating to certain rentals of property to a trade or business activity in which the taxpayer materially participates).

(iv) The law-practice undertaking, if considered as a separate activity, would not constitute a rental activity because none of the undertaking’s gross income represents amounts paid principally for the use of tangible property. Accordingly, the law-practice undertaking is not treated as a rental undertaking.

Example 6. (i) The taxpayer owns a building in which the taxpayer operates a nursing home and a medical clinic. (Assume that, under paragraph (c)(1) of this section, the operations conducted in the building are treated as a single paragraph (c) undertaking.) The nursing-home operations consist of renting apartments in the nursing home to elderly and handicapped persons and providing medical care, meals, and social activities. (Assume that these services are extraordinary personal services (within the meaning of § 1.469-1T(e)(3)(v)).) The medical clinic provides medical care to nursing-home residents and other individuals. Nursing-home residents typically occupy an apartment for at least one year. The paragraph (c) undertaking derives 55 percent of its gross income from nursing-home operations (including the provision of medical services to nursing-home residents) and 45 percent of its gross income from medical-clinic operations. The operations conducted in the building are not

incidental to any other activity of the taxpayer (within the meaning of § 1.469-1T(e)(3)(vi)).

(ii) The paragraph (c) undertaking's nursing-home operations involve the provision of tangible property (the apartments) for use by customers and the provision of property and services in connection therewith. In addition, the apartments are not short-term real properties (within the meaning of paragraph (d)(3)(ii) of this section) because the average period of customer use (within the meaning of § 1.469-1T(e)(3)(iii)) for the apartments exceeds 30 days. Accordingly, the nursing-home operations are rental operations (within the meaning of paragraph (d)(3) of this section). The medical-clinic operations do not involve the provision of tangible property for use by customers or the provision of property or services in connection therewith. Thus, the medical-clinic operations are not rental operations.

(iii) Paragraph (d)(1)(i) of this section provides, with certain exceptions, that a paragraph (c) undertaking's rental operations and its operations other than rental operations are treated as two separate undertakings. In this case, however, the nursing-home operations, if considered as a separate activity, would not constitute a rental activity because extraordinary personal services are provided in connection with making nursing-home apartments available for use by customers (see § 1.469-1T(e)(3)(ii)(C)). Thus, the exception in paragraph (d)(2)(i) of this section applies, and the nursing-home operations and the medical-clinic operations are not treated as two separate undertakings under paragraph (d)(1)(i) of this section.

(iv) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the nursing-home operations, if considered as a separate activity, would not constitute a rental activity (see (iii) above). Thus, an undertaking that includes no rental operations other than the nursing-home operations would not, if considered as a separate activity, constitute a rental activity. Accordingly, the undertaking is not treated as a rental undertaking.

Example 7. (i) The taxpayer rents and sells videocassettes. (Assumes that, under paragraph (c)(1) of this section, the videocassette operations are treated as a single paragraph (c) undertaking.) Renters of videocassettes typically keep the videocassettes for one or two days, and do not receive any other property or services in connection with videocassette rentals. The paragraph (c) undertaking derives 70 percent of its gross income from renting videocassettes and 30 percent of its gross income from selling videocassettes.

The videocassette operations are not incidental to any other activity of the taxpayer (within the meaning of § 1.469-1T(e)(3)(vi)).

(ii) The rental of videocassettes involves the provision of tangible property (the videocassettes) for use by customers. In addition, the special rules for short-term real properties contained in paragraph (d)(3)(ii) of this section do not apply in this case because the videocassettes are not real property. Thus, the operations that involve videocassette rentals are rental operations (within the meaning of paragraph (d)(3) of this section). The sale of videocassettes does not involve the provision of tangible property for use by customers or the provision of property or services in connection therewith. Thus, the operations that involve videocassette sales are not rental operations.

(iii) Paragraph (d)(1)(i) of this section provides, with certain exceptions, that a paragraph (c) undertaking's rental operations and its operations other than rental operations are treated as two separate undertakings. In this case, however, the rental operations, if considered as a separate activity, would not constitute a rental activity because the average period of customer use for rented videocassettes does not exceed seven days (see § 1.469-1T(e)(3)(ii)(A)). Accordingly, the exception in paragraph (d)(2)(i) of this section applies, and the videocassette-rental operations and videocassette-sales operations are not treated as two separate undertakings under paragraph (d)(1)(i) of this section.

(iv) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the videocassette-rental operations, if considered as a separate activity, would not constitute a rental activity (see (iii) above). Thus, an undertaking that includes no rental operations other than the videocassette-rental operations would not, if considered as a separate activity, constitute a rental activity. Accordingly, the undertaking is not treated as a rental undertaking.

Example 8. (i) The taxpayer owns a building in which the taxpayer sells, leases, and services automobiles. (Assume that, under paragraph (c)(1) of this section, the operations conducted in the building are treated as a single paragraph (c) undertaking.) The minimum lease term for any leased automobile is 31 days, and the services provided to lessees (including periodic oil changes, lubrication, and routine services and repairs) are those customarily provided in long-term automobile leases. The paragraph (c) undertaking derives 75 percent of its gross income from selling automobiles, 15 percent of its gross income from servicing automobiles

other than leased automobiles, and 10 percent of its gross income from leasing automobiles. The taxpayer's automobile operations are not incidental to any other activity of the taxpayer (within the meaning of § 1.469-1T(e)(3)(vi)).

(ii) The paragraph (c) undertaking's automobile-leasing operations involve the provision of tangible property (the automobiles) for use by customers and the provision of services in connection therewith. In addition, the special rules for short-term real properties contained in paragraph (d)(3)(ii) of this section do not apply in this case because the automobiles are not real property. Accordingly, the automobile-leasing operations are rental operations (within the meaning of paragraph (d)(3) of this section). The paragraph (c) undertaking's automobile-sales operations and servicing operations for automobiles other than leased automobiles (the "selling-and-servicing operations") do not involve the provision of tangible property for use by customers or the provision of property or services in connection therewith. Thus, the selling-and-servicing operations are not rental operations.

(iii) Paragraph (d)(1)(i) of this section provides, with certain exceptions, that a paragraph (c) undertaking's rental operations and its operations other than rental operations are treated as two separate undertakings. In this case, however, the exception in paragraph (d)(2)(ii) of this section applies because less than 20 percent of the paragraph (c) undertaking's gross income is attributable to rental operations (the "automobile-leasing operations"). Accordingly, the rental operations and the selling-and-servicing operations are not treated as two separate undertakings under paragraph (d)(1)(i) of this section.

(iv) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the undertaking (determined after the application of paragraph (d)(1)(i) of this section) includes both the selling-and-servicing operations and the automobile-leasing operations, and the gross income of the undertaking does not represent amounts paid principally for the use of tangible property. Thus, the undertaking, if considered as a separate activity, would not constitute a rental activity. Accordingly, the undertaking is not treated as a rental undertaking.

Example 9. (i) The facts are the same as in Example 8, except that the paragraph (c) undertaking derives 60 percent of its gross income from selling automobiles, 15 percent of its gross income from servicing automobiles other than leased automobiles, and 25 per-

cent of its gross income from leasing automobiles.

(ii) Paragraph (d)(1)(i) of this section provides, with certain exceptions, that a paragraph (c) undertaking's rental operations and its operations other than rental operations are treated as two separate undertakings. In this case, more than 20 percent of the paragraph (c) undertaking's gross income is attributable to rental operations (the automobile-leasing operations), and more than 20 percent is attributable to operations other than rental operations (the selling-and-servicing operations). Thus, the exceptions in paragraph (d)(2) (i) and (iii) of this section do not apply. In addition, the average period of customer use for leased automobiles exceeds 30 days, extraordinary personal services (within the meaning of § 1.469-1T(e)(3)(v)) are not provided, and the leasing of the automobiles is not treated as incidental to a nonrental activity under § 1.469-1T(e)(3)(vi) (relating to incidental rentals that are not treated as a rental activity). Thus, the leasing operations, if considered as a separate activity, would constitute a rental activity, and the exception in paragraph (d)(2)(i) of this section does not apply. Accordingly, the rental operations and the selling-and-servicing operations are treated as two separate undertakings (the "automobile-leasing undertaking" and the "automobile selling-and-servicing undertaking").

(iii) Paragraph (d)(1)(iii) of this section provides that an undertaking (determined after the application of paragraph (d)(1)(i) of this section) is treated as a rental undertaking if and only if the undertaking, considered as a separate activity, would constitute a rental activity. In this case, the automobile-leasing undertaking would, if considered as a separate activity, constitute a rental activity, and the automobile selling-and-servicing undertaking would not, if considered as a separate activity, constitute a rental activity (see Example 8 and (ii) above). Accordingly, the automobile-leasing undertaking is treated as a rental undertaking, and the automobile selling-and-servicing undertaking is not.

(e) *Special rules for certain oil and gas operations*—(1) *Wells treated as nonpassive under § 1.469-1T(e)(4)(i).* An oil or gas well shall be treated as an undertaking that is separate from other undertakings in determining the activities of a taxpayer for a taxable year if the following conditions are satisfied:

(i) The well is drilled or operated pursuant to a working interest (within the meaning of § 1.469-1T(e)(4)(iv)) and at any time during such taxable year the taxpayer holds such working interest either—

(A) Directly; or

(B) Through an entity that does not limit the liability of the taxpayer with respect to the drilling or operation of such well pursuant to such working interest; and

(ii) The taxpayer would not be treated as materially participating (within the meaning of § 1.469-5T) for the taxable year in the activity in which such well would be included if the taxpayer's activities were determined without regard to this paragraph (e).

(2) *Business and rental operations that constitute an undertaking.* In any case in which an oil or gas well is treated under this paragraph (e) as an undertaking that is separate from other undertakings, the business and rental operations that constitute such undertaking are the business and rental operations that are attributable to such well.

(3) *Examples.* The following examples illustrate the application of this paragraph (e). In each example, the taxpayer is an individual whose taxable year is the calendar year.

Example 1. During 1989, A directly owns an undivided interest in a working interest (within the meaning of § 1.469-1T(e)(4)(iv)) in two oil wells. A does not participate in the activity in which the wells would be included if A's activities were determined without regard to this paragraph (e). Under paragraph (e)(1) of this section, each well is treated as a separate undertaking in determining A's activities for 1989 because A holds the working interest directly and would not be treated as materially participating for 1989 in the activity in which the wells would be included if A's activities were determined without regard to this paragraph (e). The aggregation rules in paragraph (f) of this section do not apply to these undertakings (see paragraph (f)(1)(ii)(B) of this section). Thus, each of the undertakings is treated as a separate activity under paragraph (b)(1) of this section. The result is the same even if A has net income from one or both wells for 1989 and even if the wells would otherwise be treated as part of the same undertaking under paragraph (c) of this section. The result would also be the same if A held the working interest through an entity, such as a general partnership, that does not limit A's liability with respect to the drilling or operation of the wells pursuant to the working interest.

Example 2. (i) During 1989, B is a general partner in a partnership that owns a working interest (within the meaning of § 1.469-1T(e)(4)(iv)) in an oil well. B does not own any interest in the well other than through

the partnership. At the end of 1989, however, B's partnership interest is converted into a limited partnership interest, and during 1990 B holds the working interest only as a limited partner. B does not participate in the activity in which the well would be included if B's activities were determined without regard to this paragraph (e).

(ii) Under paragraph (e)(1) of this section, the well is treated as a separate undertaking in determining B's activities for 1989 because B holds the working interest during 1989 through an entity that does not limit B's liability with respect to the drilling or operation of the well pursuant to the working interest, and B would not be treated as materially participating for 1989 in the activity in which the well would be included if B's activities were determined without regard to this paragraph (e). Throughout 1990, however, B's liability with respect to the drilling and operation of the well is limited by the entity through which B holds the working interest (*i.e.*, the limited partnership). Accordingly, paragraph (e)(1) of this section does not apply to the well in 1990, and the well may be included under paragraph (c) of this section in an undertaking that includes other operations.

Example 3. The facts are the same as in Example 2, except that B's partnership interest is converted into a limited partnership interest at the end of November 1989. An oil or gas well may be treated as a separate undertaking under paragraph (e)(1) of this section if at any time during the taxable year the taxpayer holds a working interest in the well directly or through an entity that does not limit the taxpayer's liability with respect to the drilling or operation of the well pursuant to the working interest (see § 1.469-1T(e)(4)(i)). Thus, although B's liability with respect to the drilling and operation of the well is limited during December 1989, the result in both 1989 and 1990 is the same as in Example 2. In 1989, however, disqualified deductions and a ratable portion of the gross income from the well may be treated under § 1.469-1T(e)(4)(ii) as passive activity deductions and passive activity gross income, respectively.

(f) *Certain trade or business undertakings treated as part of the same activity—(1) Applicability—(i) In general.* This paragraph (f) applies to a taxpayer's interests in trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section).

(ii) *Trade or business undertaking.* For purposes of this paragraph (f), the term "trade or business undertaking" means any undertaking in which a taxpayer has an interest, other than—

(A) A rental undertaking (within the meaning of paragraph (d) of this section);

(B) An oil or gas well treated as an undertaking that is separate from other undertakings under paragraph (e) of this section; or

(C) A professional service undertaking (within the meaning of paragraph (h) of this section).

(2) *Treatment as part of the same activity.* A taxpayer's interests in two or more trade or business undertakings that are similar (within the meaning of paragraph (f)(4) of this section) and controlled by the same interests (within the meaning of paragraph (j) of this section) shall be treated as part of the same activity of the taxpayer for any taxable year in which the taxpayer—

(i) Owns interests in each such undertaking through the same passthrough entity;

(ii) Owns a direct or substantial indirect interest (within the meaning of paragraph (f)(3) of this section) in each such undertaking; or

(iii) Materially or significantly participates (within the meaning of § 1.469-5T) in the activity that would result if such undertakings were treated as part of the same activity.

(3) *Substantial indirect interest*—(i) *In general.* For purposes of this paragraph (f), a taxpayer owns a substantial indirect interest in an undertaking for a taxable year if at any time during such taxable year the taxpayer's ownership percentage (determined in accordance with paragraph (j)(3) of this section) in a passthrough entity that directly owns such undertaking exceeds ten percent.

(ii) *Coordination rule.* A taxpayer shall be treated for purposes of this paragraph (f) as owning a substantial indirect interest in each of two or more undertakings for any taxable year in which—

(A) Such undertakings are treated as part of the same activity of the taxpayer under paragraph (f)(2)(i) of this section; and

(B) The taxpayer owns a substantial indirect interest (within the meaning of paragraph (f)(3)(i) of this section) in any such undertaking.

(4) *Similar undertakings*—(i) *In general.* Except as provided in paragraph

(f)(4)(iii) of this section, two undertakings are similar for purposes of this paragraph (f) if and only if—

(A) There are predominant operations in each such undertaking; and

(B) The predominant operations of both undertakings are in the same line of business.

(ii) *Predominant operations.* For purposes of paragraph (f)(4)(i)(A) of this section, there are predominant operations in an undertaking if more than 50 percent of the undertaking's gross income is attributable to operations in a single line of business.

(iii) *Vertically-integrated undertakings.* If an undertaking (the “supplier undertaking”) provides property or services to other undertakings (the “recipient undertakings”), the following rules apply for purposes of this paragraph (f):

(A) *Supplier undertaking similar to recipient undertaking.* If the supplier undertaking predominantly involves the provision of property and services to a recipient undertaking that is controlled by the same interests (within the meaning of paragraph (j) of this section), the supplier undertaking shall be treated as similar to the recipient undertaking. For purposes of applying the preceding sentence—

(1) If a supplier undertaking and two or more recipient undertakings that are similar (within the meaning of paragraph (f)(4)(i) of this section) are controlled by the same interests, such recipient undertakings shall be treated as a single undertaking; and

(2) A supplier undertaking predominantly involves the provision of property and services to a recipient undertaking for any taxable year in which such recipient undertaking obtains more than 50 percent (by value) of all property and services provided by the supplier undertaking.

(B) *Recipient undertaking similar to supplier undertaking.* If the supplier undertaking is the predominant provider of property and services to a recipient undertaking that is controlled by the same interests (within the meaning of paragraph (j) of this section), the recipient undertaking shall be treated, except as otherwise provided in paragraph (f)(4)(iii)(C) of this section, as similar to the supplier undertaking. For purposes of the preceding sentence,

a supplier undertaking is the predominant provider of property and services to a recipient undertaking for any taxable year in which the supplier undertaking provides more than 50 percent (by value) of all property and services obtained by the recipient undertaking.

(C) *Coordination rules.* (1) Paragraph (f)(4)(iii)(B) of this section does not apply if, under paragraph (f)(4)(iii)(A) of this section—

(i) The supplier undertaking is treated as an undertaking that is similar to any recipient undertaking;

(ii) The recipient undertaking is treated as a supplier undertaking that is similar to another recipient undertaking; or

(iii) Another supplier undertaking is treated as an undertaking that is similar to the recipient undertaking.

(2) If paragraph (f)(4)(iii)(A) of this section applies to a supplier undertaking, the supplier undertaking shall be treated as similar to undertakings that are similar to the recipient undertaking and shall not otherwise be treated as similar to undertakings to which the supplier undertaking would be similar without regard to paragraph (f)(4)(iii) of this section.

(3) If paragraph (f)(4)(iii)(B) of this section applies to a recipient undertaking, the recipient undertaking shall be treated as similar to undertakings that are similar to the supplier undertaking and shall not otherwise be treated as similar to undertakings to which the recipient undertaking would be similar without regard to paragraph (f)(4)(iii) of this section.

(iv) *Lines of business.* The Commissioner shall establish, by revenue procedure, lines of business for purposes of this paragraph (f)(4). Business and rental operations that are not included in the lines of business established by the Commissioner shall nonetheless be included in a line of business for purposes of this paragraph (f)(4). Such operations shall be included in a single line of business or in multiple lines of business on a basis that reasonably reflects—

(A) Similarities and differences in the property or services provided pursuant to such operations and in the markets to which such property or services are offered; and

(B) The treatment within the lines of business established by the Commissioner of operations that are comparable in their similarities and differences.

(5) *Examples.* The following examples illustrate the application of this paragraph (f). In each example that does not state otherwise, the taxpayer is an individual and the facts, analysis, and conclusions relate to a single taxable year.

Example 1. (i) The taxpayer is a partner in partnerships A, B, C, and D and owns a five-percent interest in each partnership. Each partnership owns a single undertaking (undertakings A, B, C, and D), and the undertakings are trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section) that are controlled by the same interests (within the meaning of paragraph (j) of this section). In addition, undertakings A, B, and D are similar (within the meaning of paragraph (f)(4) of this section). The taxpayer is not related to any of the other partners, and does not participate in any of the undertakings.

(ii) In general, each undertaking in which a taxpayer owns an interest is treated as a single activity that is separate from other activities of the taxpayer (see paragraph (b)(1) of this section). This paragraph (f) provides aggregation rules for trade or business undertakings that are similar and controlled by the same interests. These aggregation rules do not apply, however, unless the taxpayer owns interests in the undertakings through the same passthrough entity, owns direct or substantial indirect interests in the undertakings, or materially or significantly participates in the undertakings. In this case, the taxpayer does not satisfy any of these conditions, and the aggregation rules in this paragraph (f) do not apply. Accordingly, except as otherwise provided in paragraph (g) of this section (relating to an aggregation rule for integrated businesses), undertakings A, B, C, and D are treated as separate activities of the taxpayer under paragraph (b)(1) of this section.

Example 2. (i) The facts are the same as in Example 1, except that the taxpayer owns a 25-percent interest in partnership A, a 15-percent interest in partnership B, and a 40-percent interest in partnership C.

(ii) Paragraph (f)(2)(ii) of this section provides that trade or business undertakings that are similar and controlled by the same interests are treated as part of the same activity of the taxpayer if the taxpayer owns a direct or substantial indirect interest in each such undertaking. In this case, the taxpayer owns more than ten percent of partnerships A, B, and C, and these partnerships directly own undertakings A, B, and C. Thus,

the taxpayer owns a substantial indirect interest in undertakings A, B, and C (see paragraph (f)(3)(i) of this section). Of these undertakings, only undertakings A and B are both similar and controlled by the same interests. Accordingly, the taxpayer's interests in undertakings A and B are treated as part of the same activity. As in Example 1, the aggregation rules in this paragraph (f) do not apply to undertakings C and D, and except as otherwise provided in paragraph (g) of this section, undertakings C and D are treated as separate activities.

Example 3. (i) The facts are the same as in Example 1, except that the taxpayer participates (within the meaning of § 1.469-5T(f)) for 60 hours in undertaking A and for 60 hours in undertaking B.

(ii) Paragraph (f)(2)(iii) of this section provides that trade or business undertakings that are similar and controlled by the same interests are treated as part of the same activity of the taxpayer if the taxpayer materially or significantly participates (within the meaning of § 1.469-5T) in the activity that would result from the treatment of similar, commonly-controlled undertakings as part of the same activity. In this case, the activity that would result from treating the similar, commonly-controlled undertakings as part of the same activity consists of undertakings A, B, and D, and the taxpayer participates for 120 hours in the activity that results from this treatment. Accordingly, undertakings A, B, and D are treated as part of the same activity because the taxpayer significantly participates (within the meaning of § 1.469-5T(c)(2)) in the activity that results from this treatment. The result is the same whether the taxpayer participates in one, two, or all three of the similar, commonly-controlled undertakings, so long as the taxpayer's aggregate participation in undertakings A, B, and D exceeds 100 hours. As in Example 1, the aggregation rules in this paragraph (f) do not apply to undertaking C, and except as otherwise provided in paragraph (g) of this section, undertaking C is treated as a separate activity.

Example 4. (i) The taxpayer owns a 5-percent interest in partnership A. Partnership A owns interests in partnerships B and C, each of which owns a single undertaking (undertakings B and C). In addition, the taxpayer is a partner in partnerships C and D and directly owns a 15-percent interest in each partnership. Partnership D also owns a single undertaking (undertaking D). Undertakings B, C, and D are trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section) that are similar (within the meaning of paragraph (f)(4) of this section) and controlled by the same interests (within the meaning of paragraph (j) of this section). The taxpayer does not participate in undertaking B, C, or D.

(ii) Paragraph (f)(2)(i) of this section provides that trade or business undertakings that are similar and controlled by the same interests are treated as part of the same activity of the taxpayer if the taxpayer owns interests in the undertakings through the same passthrough entity. In this case, the taxpayer owns interests in undertakings B and C through partnership A. Thus, the taxpayer's interests in undertakings B and C are treated as part of the same activity.

(iii) Paragraph (f)(2)(ii) of this section provides that trade or business undertakings that are similar and controlled by the same interests are treated as part of the same activity of the taxpayer if the taxpayer owns a direct or substantial indirect interest in each such undertaking. In this case, the taxpayer owns more than ten percent of partnerships C and D, and these partnerships directly own undertakings C and D. Thus, the taxpayer owns a substantial indirect interest in undertakings C and D (see paragraph (f)(3)(i) of this section).

(iv) The coordination rule in paragraph (f)(3)(ii) of this section applies to undertakings B and C because they are treated as part of the same activity under paragraph (f)(2)(i) of this section, and the taxpayer owns a substantial indirect interest in undertaking C. Under the coordination rule, the taxpayer is treated as owning a substantial indirect interest in undertaking B as well as undertaking C. Accordingly, the taxpayer's interests in undertakings B, C, and D are treated as part of the same activity.

Example 5. (i) Undertakings A, B, C, and D are trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section), each of which involves the operation of a department store, restaurants, and movie theaters. The following table shows, for each undertaking, the percentages of gross income attributable to the various operations of the undertaking.

	Department store	Restau- rants	Movie Theaters
Undertaking A	70%	20%	10%
Undertaking B	60%	20%	20%
Undertaking C	35%	35%	30%
Undertaking D	35%	10%	55%

(ii) Paragraph (f)(4)(i) of this section provides that two undertakings are similar for purposes of this paragraph (f) if and only if there are predominant operations in each undertaking and the predominant operations of the two undertakings are in the same line of business. (Assume that the applicable revenue procedure provides that "general merchandise stores," "eating and drinking places," and "motion picture services" are three separate lines of business.)

(iii) Undertaking A and undertaking B each derives more than 50 percent of its

gross income from department-store operations, which are in the general-merchandise-store line of business. Thus, there are predominant operations in undertaking A and undertaking B, and the predominant operations of the two undertakings are in the same line of business. Accordingly, undertakings A and B are similar.

(iv) Undertaking C does not derive more than 50 percent of its gross income from operations in any single line of business. Thus, there are no predominant operations in undertaking C, and undertaking C is not similar to any of the other undertakings.

(v) Undertaking D derives more than 50 percent of its gross income from movie-theater operations, which are in the motion-picture-services line of business. Thus, there are predominant operations in undertaking D. The predominant operations of undertaking D, however, are not in the same line of business as those of undertakings A and B. Accordingly, undertaking D is not similar to undertakings A and B.

Example 6. (i) Undertakings A and B are trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section) that derive all of their gross income from the sale of automobiles. Undertakings C and D derive all of their gross income from the rental of automobiles. Undertaking C is not a rental undertaking (within the meaning of paragraph (d)(1)(iii) of this section) because the average period of customer use (within the meaning of § 1.469-1T(e)(3)(iii)) for its automobiles does not exceed seven days (see § 1.469-1T(e)(3)(ii)(A)). Undertaking D, on the other hand, leases automobiles for periods of one year or more and is a rental undertaking.

(ii) Paragraph (f)(4)(i) of this section provides that two undertakings are similar for purposes of this paragraph (f) if and only if there are predominant operations in each undertaking and the predominant operations of the two undertakings are in the same line of business. (Assume that the applicable revenue procedure provides that (a) “automotive dealers and service stations” (automotive retail) and (b) “auto repair, services (including rentals), and parking” (automotive services) are two separate lines of business.)

(iii) Undertakings A and B both derive more than 50 percent of their gross income from operations in the automotive-retail line of business (the automobile-sales operations). Similarly, undertakings C and D both derive more than 50 percent of their gross income from operations in the automotive-services line of business (the automobile-rental operations). Thus, there are predominant operations in each undertaking, the predominant operations of undertakings A and B are in the same line of business, and the predominant operations of undertakings C and D are in the same line of business. Ac-

cordingly, undertakings A and B are similar, undertakings C and D are similar, and undertakings A and B are not similar to undertakings C and D.

(iv) Paragraph (f)(1) of this section provides that this paragraph (f) applies only to trade or business undertakings and that a rental undertaking is not a trade or business undertaking. Accordingly, this paragraph (f) does not apply to undertaking D, and undertakings C and D, although similar, are not treated, under this paragraph (f), as part of the same activity.

Example 7. (i) Undertakings A, B, and C are trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section) that involve real estate operations. Undertaking A derives all of its gross income from the development of real property, undertaking B derives all of its gross income from the management of real property and the performance of services as a leasing agent with respect to real property, and undertaking C derives all of its gross income from buying, selling, or arranging purchases and sales of real property. Undertaking D derives all of its gross income from the rental of residential apartments and is a rental undertaking (within the meaning of paragraph (d)(1)(iii) of this section).

(ii) Paragraph (f)(4)(i) of this section provides that two undertakings are similar for purposes of this paragraph (f) if there are predominant operations in each undertaking and the predominant operations of the two undertakings are in the same line of business. (Assume that the applicable revenue procedure provides that real estate development and services (including the development and management of real property, dealing in real property, and the performance of services as a leasing agent with respect to real property) is a single line of business (the “real-estate” line of business).)

(iii) Undertakings A, B, and C all derive more than 50 percent of their gross income from operations in the real-estate line of business. Thus, there are predominant operations in undertakings A, B, and C, and the predominant operations of the three undertakings are in the same line of business. Accordingly, undertakings A, B, and C are similar.

(iv) Undertaking D also derives more than 50 percent of its gross income from operations in the real-estate line of business. Thus, there are predominant operations in undertaking D, and the predominant operations of undertaking D are in the same line of business as those of undertakings A, B, and C. Paragraph (f)(1) of this section provides, however, that this paragraph (f) applies only to trade or business undertakings and that a rental undertaking is not a trade or business undertaking. Accordingly, this paragraph (f) does not apply to undertaking D, and undertaking D, although similar to

undertakings A, B, and C, is not treated, under this paragraph (f), as part an activity that includes undertaking A, B, or C.

Example 8. (i) Undertakings A and B are trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section), both of which involve the provision of moving services. Undertaking A derives its gross income principally from local moves, and undertaking B derives its gross income principally from long-distance moves.

(ii) Paragraph (f)(4)(i) of this section provides that two undertakings are similar for purposes of this paragraph (f) if there are predominant operations in each undertaking and the predominant operations of the two undertakings are in the same line of business. Under paragraph (f)(4)(iv) of this section, operations that are not in the lines of business established by the applicable revenue procedure are nonetheless included in a line of business. In addition, such operations are included in a single line of business or in multiple lines of business on a basis that reasonably reflects (a) similarities and differences in the property or services provided pursuant to such operations and in the markets to which such property or services are offered, and (b) the treatment within the lines of business established by the Commissioner of operations that are comparable in their similarities and differences. (Assume that the provision of moving services is not in any line of business established by the Commissioner and that within the lines of business established by the Commissioner services that differ only in the distance over which they are performed (*e.g.*, local and long-distance telephone services) are generally treated as part of the same line of business.)

(iii) Undertakings A and B provide the same types of services to similar customers, and the only significant difference in the services provided is the distance over which they are performed. Thus, treating local and long-distance moving services as a single line of business (the “moving-services” line of business) reasonably reflects the treatment within the lines of business established by the Commissioner of operations that are comparable in their similarities and differences.

(iv) Each undertaking derives more than 50 percent of its gross income from operations in the moving-services line of business. Thus, there are predominant operations in each undertaking, and the predominant operations of the two undertakings are in the same line of business. Accordingly, undertakings A and B are similar.

Example 9. (i) Undertakings A, B, C, D, and E are trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section) and are controlled by the same interests (within the meaning of paragraph (j) of this section). Undertakings A, B, and C de-

rive all of their gross income from retail sales of dairy products, and undertakings D and E derive all of their gross income from the processing of dairy products. Undertakings D and E sell less than ten percent of their dairy products to undertakings A, B, and C, and sell the remainder to unrelated undertakings. Undertakings A, B, and C purchase less than ten percent of their inventory from undertakings D and E and purchase the remainder from unrelated undertakings.

(ii) Paragraph (f)(4)(i) of this section provides that, except as provided in paragraph (f)(4)(iii) of this section, undertakings are similar for purposes of this paragraph (f) if and only if there are predominant operations in each undertaking and the predominant operations of the undertakings are in the same line of business. (Assume that the applicable revenue procedure provides that (a) “food stores” and (b) “manufacturing—food and kindred products” are two separate lines of business.)

(iii) Undertakings A, B, and C all derive more than 50 percent of their gross income from operations in the food-store line of business (the dairy-sales operations). Thus, there are predominant operations in undertakings A, B, and C, and the predominant operations of the three undertakings are in the same line of business. Accordingly, undertakings A, B, and C are similar.

(iv) Undertakings D and E both derive more than 50 percent of their gross income from operations in the food-manufacturing line of business (the dairy-processing operations). Thus, there are predominant operations in undertakings D and E, and the predominant operations of the two undertakings are in the same line of business. Accordingly, undertakings D and E are similar. The predominant operations of undertakings D and E are not in the same line of business as those of undertakings A, B, and C. Accordingly, undertakings D and E are not similar to undertakings A, B, and C.

(v) Paragraph (f)(4)(iii) of this section provides rules under which certain undertakings whose operations are not in the same line of business nevertheless are similar to one another if one of the undertakings (the “supplier undertaking”) provides property or services to the other undertaking (the “recipient undertaking”), and the undertakings are controlled by the same interests. These rules apply, however, only if the supplier undertaking predominantly involves the provision of property and services to the recipient undertaking (see paragraph (f)(4)(iii)(A) of this section), or the supplier undertaking is the predominant provider of property and services to the recipient undertaking (see paragraph (f)(4)(iii)(B) of this section). In this case, undertakings D and E are supplier undertakings, and undertakings A, B, and C are recipient undertakings. Undertakings D

and E, however, sell less than ten percent of their dairy products to undertakings A, B, and C and thus do not predominantly involve the provision of property and services to recipient undertakings. Similarly, undertakings D and E are not the predominant providers of property and services to undertakings A, B, and C. Thus, the rules for vertically-integrated undertakings in paragraph (f)(4)(iii) of this section do not apply in this case.

Example 10. (i) The facts are the same as in Example 9, except that undertaking D sells 75 percent of its dairy products to undertakings A, B, and C.

(ii) Paragraph (f)(4)(iii)(A) of this section applies if a supplier undertaking predominantly involves the provision of property to a recipient undertaking that is controlled by the same interests. Paragraph (f)(4)(iii)(A)(2) of this section provides that a supplier undertaking predominantly involves the provision of property to a recipient undertaking if the supplier undertaking provides more than 50 percent of its property to such recipient undertaking. In addition, paragraph (f)(4)(iii)(A)(I) of this section provides that if a supplier undertaking and two or more similar recipient undertakings are controlled by the same interests, the recipient undertakings are treated as a single undertaking for purposes of applying paragraph (f)(4)(iii)(A) of this section. Undertakings D and E both provide dairy products to undertakings A, B, and C. Thus, for purposes of paragraph (f)(4)(iii) of this section, undertakings D and E are supplier undertakings and undertakings A, B, and C are recipient undertakings. Undertaking D predominantly involves the provision of property to undertakings A, B, and C. Moreover, undertakings A, B, and C are treated as a single undertaking under paragraph (f)(4)(iii)(A)(I) of this section because undertakings A, B, and C are similar to one another under paragraph (f)(4)(i) of this section, and undertakings A, B, C, and D are controlled by the same interests. Accordingly, paragraph (f)(4)(iii)(A) of this section applies to undertakings A, B, C, and D.

(iii) If paragraph (f)(4)(iii)(A) of this section applies to supplier and recipient undertakings, the supplier undertaking is treated under paragraph (f)(4)(iii)(A) and (C)(2) of this section as an undertaking that is similar to the recipient undertakings and to undertakings to which the recipient undertakings are similar. Accordingly, undertaking D is similar, for purposes of this paragraph (f), to undertakings A, B, and C.

(iv) Undertaking E does not predominantly involve the provision of property to undertakings A, B, and C, or to any other related undertakings. Thus, paragraph (f)(4)(iii)(A) of this section does not apply to undertaking E, and undertaking E is not similar to undertakings A, B, and C. Moreover, undertakings

D and E are not similar because, under paragraph (f)(4)(iii)(C)(2) of this section, undertaking D is not similar to any undertaking that is not similar to undertakings A, B, and C.

Example 11. (i) The facts are the same as in Example 10, except that 75 percent of undertaking D's dairy products are sold to undertakings A and B, and none are sold to undertaking C.

(ii) In this case, undertaking D is a supplier undertaking only with respect to undertakings A and B. Accordingly, paragraph (f)(4)(iii)(A) applies only to undertakings A, B, and D. As in Example 10, undertaking D is similar to undertakings A and B, and is not similar to undertaking E. In addition, if paragraph (f)(4)(iii)(A) of this section applies to supplier and recipient undertakings, the supplier undertaking is treated under paragraph (f)(4)(iii)(C)(2) of this section as an undertaking that is similar to the recipient undertakings and undertakings to which the recipient undertakings are similar. Accordingly, even though undertaking D does not provide any property or services to undertaking C, undertaking D is similar to undertaking C because undertaking C is similar to undertakings A and B.

Example 12. (i) The facts are the same as in Example 9, except that undertakings A and B purchase 80 percent of their inventory from undertaking D.

(ii) Paragraph (f)(4)(iii)(B) of this section applies, except as provided in paragraph (f)(4)(iii)(C) of this section, if a supplier undertaking is the predominant provider of property to a recipient undertaking that is controlled by the same interests. Undertakings D and E both provide dairy products to undertakings A, B, and C. Thus, for purposes of paragraph (f)(4)(iii) of this section, undertakings D and E are supplier undertakings, and undertakings A, B, and C are recipient undertakings. In addition, undertaking D is the predominant provider of property and services to undertakings A and B, and undertakings A, B and D are controlled by the same interests. Thus, except as provided in paragraph (f)(4)(iii)(C) of this section, paragraph (f)(4)(iii)(B) of this section applies to undertakings A, B, and D.

(iii) The coordination rules in paragraph (f)(4)(iii)(C)(I) of this section provide that paragraph (f)(4)(iii)(B) of this section does not apply in certain cases to which paragraph (f)(4)(iii)(A) of this section applies. These coordination rules would apply if undertaking D or E (or any other undertaking that is controlled by the interests that control undertakings A, B, and C) predominantly involved the provision of property and services to undertakings A, B, and C. The coordination rules in paragraph (f)(4)(iii)(C)(I) of this section would also apply if undertaking A, B, or D predominantly involved the provision of property or

services to a recipient undertaking that is controlled by the same interests. Assume that these coordination rules do not apply in this case.

(iv) If paragraph (f)(4)(iii)(B) of this section applies to supplier and recipient undertakings, the recipient undertakings are treated under paragraph (f)(4)(iii)(B) and (C)(3) of this section as undertakings that are similar to the supplier undertaking and to undertakings to which the supplier undertaking is similar. Accordingly, undertakings A and B are similar, for purposes of this paragraph (f), to undertaking D and, because undertakings D and E are similar, to undertaking E.

(v) The principal providers of property and services to undertaking C are unrelated undertakings. Thus, paragraph (f)(4)(iii)(B) of this section does not apply to undertaking C, and undertaking C is not similar to undertakings D and E. Moreover, undertaking C is not similar to undertakings A and B because, under paragraph (f)(4)(iii)(C)(3) of this section, undertakings A and B are not similar to any undertaking that is not similar to undertaking D.

Example 13. (i) Undertakings A through Z are trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section) and are controlled by the same interests (within the meaning of paragraph (j) of this section). Undertaking A derives all of its gross income from the manufacture and sale of men's and women's clothing, undertaking B derives all of its gross income from sales of men's and women's clothing to retail stores, and undertakings C through Z derive all of their gross income from retail sales of men's and women's clothing. Undertaking A sells clothing exclusively to undertaking B. Undertaking B sells 75 percent of its clothing to undertakings C through Z, and sells the remainder to unrelated retail stores. Undertaking B purchases 80 percent of its inventory from undertaking A, and undertakings C through Z purchase 60 to 90 percent of their inventory from undertaking B.

(ii) Paragraph (f)(4)(iii)(A) of this section applies if a supplier undertaking predominantly involves the provision of property to a recipient undertaking that is controlled by the same interests. In addition, paragraph (f)(4)(iii)(A)(I) of this section provides that if a supplier undertaking and two or more similar recipient undertakings are controlled by the same interests, the recipient undertaking are treated as a single undertaking for this purpose. Undertaking B provides men's and women's clothing to undertaking C through Z. Thus, for purposes of paragraph (f)(4)(iii) of this section, undertaking B is a supplier undertaking and undertakings C through Z are recipient undertakings. In addition, undertaking B predominantly involves the provision of property to undertakings C through Z, and undertakings

C through Z are treated as a single undertaking for purposes of paragraph (f)(4)(iii)(A) of this section. Accordingly, paragraph (f)(4)(iii)(A) of this section applies to undertakings B and C through Z.

(iii) If paragraph (f)(4)(iii)(A) of this section applies to supplier and recipient undertakings, the supplier undertaking is treated under paragraph (f)(4)(iii)(A) of this section as an undertaking that is similar to the recipient undertakings. Accordingly, undertaking B is similar, for purposes of this paragraph (f), to undertakings C through Z.

(iv) Undertaking A provides men's and women's clothing to undertaking B. Thus, for purposes of paragraph (f)(4)(iii) of this section, undertaking A is a supplier undertaking and undertaking B is a recipient undertaking. In addition, undertaking A predominantly involves the provision of property to undertaking B, and undertakings A and B are controlled by the same interests. Accordingly, paragraph (f)(4)(iii)(A) of this section applies to undertakings A and B, and undertaking A is similar to undertaking B.

(v) If paragraph (f)(4)(iii)(A) of this section applies to supplier and recipient undertakings, the supplier undertaking is treated under paragraph (f)(4)(iii)(C)(2) of this section as an undertaking that is similar to undertakings to which the recipient undertakings are similar. Accordingly, undertaking A is also similar, for purposes of this paragraph (f), to undertakings C through Z.

(vi) The coordination rule in paragraph (f)(4)(iii)(C)(I)(i) of this section provides that paragraph (f)(4)(iii)(B) of this section does not apply if, as described above, the supplier undertaking predominantly involves the provision of property to recipient undertakings and is treated under paragraph (f)(4)(iii)(A) of this section as an undertaking that is similar to such recipient undertakings. Accordingly, paragraph (f)(4)(iii)(B) of this section does not apply to undertakings B through Z, even though undertaking B is the predominant provider of property and services to undertakings C through Z, and undertakings B through Z are controlled by the same interests. For the same reason, paragraph (f)(4)(iii)(B) of this section does not apply to undertaking A and B. (Paragraph (f)(4)(iii)(B) of this section is also inapplicable to undertakings A and B because the coordination rule in paragraph (f)(4)(iii)(C)(I)(ii) of this section applies if the recipient undertaking (undertaking B) is itself a supplier undertaking that is treated under paragraph (f)(4)(iii)(A) of this section as an undertaking that is similar to its recipient undertakings (undertakings C through Z).)

(g) *Integrated businesses*—(1) *Applicability*—(i) *In general.* This paragraph (g) applies to a taxpayer's interests in trade or business activities (within the

meaning of paragraph (g)(1)(ii) of this section).

(ii) *Trade or business activity.* For purposes of this paragraph (g), the term “trade or business activity” means any activity (determined without regard to this paragraph (g)) that consists of interests in one or more trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section).

(2) *Treatment as a single activity.* A taxpayer’s interests in two or more trade or business activities shall be treated as a single activity if and only if—

(i) The operations of such trade or business activities constitute a single integrated business, activities constitute a single integrated business; and

(ii) Such activities are controlled by the same interests (within the meaning of paragraph (j) of this section).

(3) *Facts and circumstances test.* In determining whether the operations of two or more trade or business activities constitute a single integrated business for purposes of this paragraph (g), all the facts and circumstances are taken into account, and the following factors are generally the most significant:

(i) Whether such operations are conducted at the same location;

(ii) The extent to which other persons conduct similar operations at one location;

(iii) Whether such operations are treated as a unit in the primary accounting records reflecting the results of such operations;

(iv) The extent to which other persons treat similar operations as a unit in the primary accounting records reflecting the results of such similar operations;

(v) Whether such operations are owned by the same person (within the meaning of paragraph (c)(2)(v) of this section);

(vi) The extent to which such operations involve products or services that are commonly provided together;

(vii) The extent to which such operations serve the same customers;

(viii) The extent to which the same personnel, facilities, or equipment are used to conduct such operations;

(ix) The extent to which such operations are conducted in coordination with or reliance upon each other;

(x) The extent to which the conduct of any such operations is incidental to the conduct of the remainder of such operations;

(xi) The extent to which such operations depend on each other for their economic success; and

(xii) Whether such operations are conducted under the same trade name.

(4) *Examples.* The following examples illustrate the application of this paragraph (g). The facts, analysis, and conclusion in each example relate to a single taxable year, and the trade or business activities described in each example are controlled by the same interests (within the meaning of paragraph (j) of this section).

Example 1. (i) The taxpayer owns a number of department stores and auto-supply stores. Some of the taxpayer’s department stores include auto-supply departments. In other cases, the taxpayer operates a department store and an auto-supply store at the same location (within the meaning of paragraph (c)(2)(iii) of this section), or at different locations from which the same group of customers can be served. In cases in which a department store and an auto-supply store are operated at the same location, the department-store operations are the predominant operations (within the meaning of paragraph (f)(4)(ii) of this section), and the undertaking that includes the stores is treated as a department-store undertaking for purposes of paragraph (f) of this section. Under paragraph (f) of this section, the department-store undertakings are all treated as part of the same activity of the taxpayer (the “department-store activity”). Similarly, the auto-supply undertakings (*i.e.*, the auto-supply stores that are not operated at a department-store location) are all treated as part of the same activity (the “auto-supply activity”). (Assume that department-store undertakings and auto-supply undertakings are not similar and are not treated as part of the same activity under paragraph (f) of this section.)

(ii) The department stores and auto-supply stores use a common trade name and coordinate their marketing activities (*e.g.*, the stores advertise in the same catalog and the same newspaper supplements, honor the same credit cards (including credit cards issued by the department stores), and jointly conduct sales and other promotional activities). Although sales personnel generally

work only in a particular store or in a particular department within a store, other employees (*e.g.*, cashiers, janitorial and maintenance workers, and clerical staff) may work in or perform services for various stores, including both department and auto-supply stores. In addition, the management of store operations is organized on a geographical basis, and managers above the level of the individual store generally supervise operations in both types of store. A central office provides payroll, financial, and other support services to all stores and establishes pricing and other business policies. Most inventory for both types of stores is acquired through a central purchasing department and inventory for all stores in an area is stored in a common warehouse.

(iii) Based on the foregoing facts and circumstances, the operations of the department-store activity and the auto-supply activity constitute an integrated business. Paragraph (g)(3) of this section provides that the factors relevant to this determination include the conduct of department-store and auto-supply operations at the same location, the location of department and auto-supply stores at sites where the same group of customers can be served, the treatment of all such operations as a unit in the taxpayer's financial statements, the taxpayer's ownership and the common management of all such operations, the use of the same personnel, facilities, and equipment to conduct and support the operations, the use of a common trade name, and the coordination (as evidenced by the coordinated marketing activities) of department-store and auto-supply operations.

(iv) Paragraph (g)(2) of this section provides that a taxpayer's interests in two or more trade or business activities (within the meaning of paragraph (g)(1)(ii) of this section) are treated as a single activity of the taxpayer if the operations of such activities constitute an integrated business and the activities are controlled by the same interests. The department-store activity and the auto-supply activity consist of trade or business undertakings and, thus, are trade or business activities. In addition, the activities are controlled by the same interests (the taxpayer), and the operations of the activities constitute an integrated business. Accordingly, the department-store activity and the auto-supply activity are treated as a single activity of the taxpayer.

Example 2. (i) The taxpayer owns a number of stores that sell stereo equipment and a repair shop that services stereo equipment. Under paragraph (f) of this section, the stores are all treated as part of the same activity of the taxpayer (the "store activity"). The repair shop does not sell stereo equipment, does not predominantly involve the provision of services to the taxpayer's stores, and is treated as a separate activity (the

"repair-shop activity"). (Assume that stereo-sales undertakings and stereo-repair undertakings are not similar and are not treated as part of the same activity under paragraph (f) of this section.)

(ii) The stores sell stereo equipment produced by manufacturers for which the stores are an authorized distributor. The repair shop's operations principally involve the servicing of stereo equipment produced by the same manufacturers. These operations include repairs on equipment under warranty for which reimbursement is received from the manufacturer and reconditioning of equipment taken as trade-ins by the taxpayer's stores. The majority of the operations, however, involve repairs that are performed for customers and are not covered by a warranty. The taxpayer's distribution agreements with manufacturers generally require the taxpayer to repair and service equipment produced by the manufacturer both during and after the warranty period. In some cases, the distribution agreements require that the taxpayer's repair facility meet the manufacturer's standards and provide for periodic inspections to ensure that these standards are met.

(iii) The stores and the repair shop use a common trade name. Sales personnel generally work only in a particular store and stereo technicians work only in the repair shop. The stores and the repair shop are, however, managed from a central office, which supervises both store and repair-shop operations, provides payroll, financial, and other support services to the stores and the repair shop, and establishes pricing and other business policies. In addition, inventory for the stores and supplies for the repair shop are acquired through a central purchasing department and are stored in a single warehouse.

(iv) Based on the foregoing facts and circumstances, the operations of the store activity and the repair-shop activity constitute an integrated business. Paragraph (g)(3) of this section provides that the factors relevant to this determination include the treatment of all such operations as a unit in the taxpayer's financial statements, the taxpayer's ownership and the common management of all such operations, the use of the same personnel and facilities to support the operations, the use of a common trade name, the extent to which the same customers patronize both the stores and the repair shop, the similarity of the products (*i.e.*, stereo equipment) involved in both store and repair-shop operations, and the extent to which the provision of repair services contributes to the taxpayer's ability to obtain the stereo equipment sold in store operations.

(v) Paragraph (g)(2) of this section provides that a taxpayer's interests in two or more trade or business activities (within the

meaning of paragraph (g)(1)(ii) of this section) are treated as a single activity of the taxpayer if the operations of such activities constitute an integrated business and the activities are controlled by the same interests. The store activity and repair-shop activity consist of trade or business undertakings and thus are trade or business activities. In addition, the activities are controlled by the same interests (the taxpayer), and the operations of the activities constitute an integrated business. Accordingly, the store activity and the repair-shop activity are treated as a single activity of the taxpayer.

Example 3. (i) The taxpayer owns interests in three partnerships. One partnership owns a television station, the second owns a professional sports franchise, and the third owns a motion-picture production company. The operations of the partnerships are treated as three separate undertakings. Although other persons own interests in the partnerships, all three undertakings are controlled (within the meaning of paragraph (j) of this section) by the taxpayer. The operations of the partnerships are treated as three separate activities (the “television activity,” the “sports activity,” and the “motion-picture activity”). (Assume that the undertakings are not similar and are not treated as part of the same activity under paragraph (f) of this section.)

(ii) Each partnership prepares financial statements that reflect only the results of that partnership’s operations, and each of the activities is conducted under its own trade name. The taxpayer participates extensively in the management of each partnership and makes the major business decisions for all three partnerships. Each partnership, however, employs separate management and other personnel who conduct its operations on a day-to-day basis. The taxpayer generally arranges the partnerships’ financing and often obtains loans for two, or all three, partnerships from the same source. Although the assets of one partnership are not used as security for loans to another partnership, the taxpayer’s interest in a partnership may secure loans to the other partnerships. The television station broadcasts the sports franchise’s games, and the motion-picture production company occasionally prepares programming for the television station. In addition, support staff of one partnership may, during periods of peak activity or in the case of emergency, be made available to another partnership on a temporary basis. There are no other significant transactions between the partnerships. Moreover, all transactions between the partnerships involve essentially the same terms as would be provided in transactions between unrelated persons.

(iii) Based on the foregoing facts and circumstances, the television activity, the sports activity, and the motion-picture activity constitute three separate businesses.

Paragraph (g)(3) of this section provides that the factors relevant to this determination include the treatment of the activities as separate units in the partnerships’ financial statements, the use of a different trade name for each activity, the separate day-to-day management of the activities, and the limited extent to which the activities contribute to or depend on each other (as evidenced by the small number of significant transactions between the partnerships and the arm’s length nature of those transactions). The taxpayer’s participation in management and financing are taken into account in this determination, as are the transactions between the partnerships, but these factors do not of themselves support a determination that the activities constitute an integrated business.

(iv) Paragraph (g)(2) of this section provides that a taxpayer’s interests in two or more trade or business activities (within the meaning of paragraph (g)(1)(ii) of this section) are treated as a single activity of the taxpayer only if the operations of such activities constitute an integrated business and the activities are controlled by the same interests. In this case, the taxpayer’s activities do not constitute an integrated business, and the aggregation rule in paragraph (g)(2) of this section does not apply. Accordingly, the television activity, the sports activity, and the motion-picture activity are treated as three separate activities of the taxpayer.

(h) *Certain professional service undertakings treated as a single activity—(1) Applicability—(i) In general.* This paragraph (h) applies to a taxpayer’s interests in professional service undertakings (within the meaning of paragraph (h)(1)(ii) of this section).

(ii) *Professional service undertaking.* For purposes of this paragraph (h), an undertaking is treated as a professional service undertaking for any taxable year in which the undertaking derives more than 50 percent of its gross income from the provision of services that are treated, for purposes of section 448 (d)(2)(A) and the regulations thereunder, as services performed in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.

(2) *Treatment as a single activity—(i) Undertakings controlled by the same interest.* A taxpayer’s interests in two or more professional service undertakings that are controlled by the same interests (within the meaning of paragraph (j) of this section) shall be treated as part of the same activity of the taxpayer.

(ii) *Undertakings involving significant similar or significant related services.* A taxpayer's interests in two or more professional service undertakings that involve the provision of significant similar services or significant related services shall be treated as part of the same activity of the taxpayer.

(iii) *Coordination rule.* (A) Except as provided in paragraph (h)(2)(iii)(B) of this section, a taxpayer's interests in two or more undertakings (the "original undertakings") that are treated as part of the same activity of the taxpayer under the provisions of paragraph (h)(2) (i) or (ii) of this section shall be treated as interests in a single professional service undertaking (the "aggregated undertaking") for purposes of reapplying such provisions.

(B) If any original undertaking included in an aggregated undertaking and any other undertaking that is not included in such aggregated undertaking involve the provision of significant similar or related services, the aggregated undertaking and such other undertaking shall be treated as undertakings that involve the provision of significant similar or related services for purposes of reapplying the provisions of paragraph (h)(2)(ii) of this section.

(3) *Significant similar or significant related services.* For purposes of this paragraph (h)—

(i) Services (other than consulting services) in any field described in paragraph (h)(1)(ii) of this section are similar to all other services in the same field;

(ii) All the facts and circumstances are taken into account in determining whether consulting services are similar;

(iii) Two professional service undertakings involve the provision of significant similar services if and only if—

(A) Each such undertaking provides significant professional services; and

(B) Significant professional services provided by one such undertaking are similar to significant professional services provided by the other such undertaking;

(iv) Services are significant professional services if and only if such services are in a field described in paragraph (h)(1)(ii) of this section and more

than 20 percent of the undertaking's gross income is attributable to services in such field (or, in the case of consulting services, to similar services in such field); and

(v) Two professional service undertakings involve the provision of significant related services if and only if more than 20 percent of the gross income of one such undertaking is derived from customers that are also customers of the other such undertaking.

(4) *Examples.* The following examples illustrate the application of this paragraph (h). In each example that does not state otherwise, the taxpayer is an individual, and the facts, analysis, and conclusions relate to a single taxable year.

Example 1. (i) The taxpayer is a partner in a law partnership that has offices in various cities. Some of the partnership's offices provide a full range of legal services. Other offices, however, specialize in a particular area or areas of the law (e.g., litigation, tax law, corporate law, etc.). In either case, substantially all of the office's gross income is derived from the provision of legal services. Under paragraph (c)(1) of this section, each of the law partnership's offices is treated as a single undertaking that is separate from other undertakings (a "law-office undertaking").

(ii) Each law-office undertaking derives more than 50 percent of its gross income from the provision of services in the field of law. Thus, each such undertaking is treated as a professional service undertaking (within the meaning of paragraph (h)(1)(ii) of this section).

(iii) Each law-office undertaking derives more than 20 percent of its gross income from services in the field of law. Thus, each such undertaking involves significant professional services (within the meaning of paragraph (h)(3)(iv) of this section) in the field of law. In addition, all services in the field of law are treated as similar services under paragraph (h)(3)(i) of this section. Thus, the law-office undertakings involve the provision of significant similar services (within the meaning of paragraph (h)(3)(iii) of this section).

(iv) Paragraph (h)(2)(ii) of this section provides that a taxpayer's interest in professional service undertakings that involve the provision of significant similar services are treated as part of the same activity of the

taxpayer. Accordingly, the taxpayer's interests in the law-office undertakings are treated as part of the same activity of the taxpayer under paragraph (h)(2)(ii) of this section even if the undertakings are not controlled by the same interests (within the meaning of paragraph (j) of this section).

Example 2. (i) The taxpayer is a partner in medical partnerships A and B. Both partnerships derive all of their gross income from the provision of medical services, but partnership A specializes in internal medicine and partnership B operates a radiology laboratory. Under paragraph (c)(1) of this section, the medical-service business of each partnership is treated as a single undertaking that is separate from other undertakings (a "medical-service undertaking"). Partnerships A and B are not controlled by the same interests (within the meaning of paragraph (j) of this section).

(ii) Each partnership's medical-service undertaking derives more than 50 percent of its gross income from the provision of services in the field of health. Thus, each partnership's medical-service undertaking is treated as a professional service undertaking (within the meaning of paragraph (h)(1)(ii) of this section).

(iii) Each partnership's medical-service undertaking derives more than 20 percent of its gross income from services in the field of health. Thus, each such undertaking involves significant professional services (within the meaning of paragraph (h)(3)(iv) of this section) in the field of health. In addition, all services in the field of health are treated as similar services under paragraph (h)(3)(i) of this section. Thus, the medical-services undertakings of partnerships A and B involve the provision of significant similar services (within the meaning of paragraph (h)(3)(iii) of this section).

(iv) Paragraph (h)(2)(ii) of this section provides that a taxpayer's interests in professional service undertakings that involve the provision of significant similar services are treated as part of the same activity of the taxpayer. Accordingly, the taxpayer's interests in the medical-service undertakings of partnerships A and B are treated as part of the same activity of the taxpayer under paragraph (h)(2)(ii) of this section even though the undertakings are not controlled by the same interests.

Example 3. (i) The facts are the same as in Example 2, except that the taxpayer withdraws from partnership A in 1989 and becomes a partner in partnership B in 1990. In addition, the taxpayer was a full-time participant in the operations of partnership A from 1970 through 1989, but does not participate in the operations of partnership B.

(ii) Paragraph (h)(2)(ii) of this section provides that a taxpayer's interests in professional service undertakings that involve the provision of significant similar services are

treated as part of the same activity of the taxpayer. This rule is not limited to cases in which the taxpayer holds such interests simultaneously. Thus, as in Example 2, the taxpayer's interests in the medical-service undertakings of partnerships A and B are treated as part of the same activity of the taxpayer.

(iii) The activity that includes the taxpayer's interests in the medical-service undertakings of partnerships A and B is a personal service activity (within the meaning of § 1.469-5T(d)) because it involves the performance of personal services in the field of health. In addition, the taxpayer materially participated in the activity for three or more taxable years preceding 1990 (see § 1.469-5T(j)(1)). Thus, even if the taxpayer does not work in the activity after 1989, the taxpayer is treated, under § 1.469-5T(a)(6), as materially participating in the activity for 1990 and subsequent taxable years.

Example 4. (i) The taxpayer is a partner in an accounting partnership that has offices in various cities (partnership A) and in a management-consulting partnership that has a single office (partnership B). Each of partnership A's offices derives substantially all of its gross income from services in the field of accounting, and partnership B derives substantially all of its gross income from services in the field of consulting. Under paragraph (c)(1) of this section, partnership B's consulting business is treated as a single undertaking that is separate from other undertakings (the "consulting undertaking") and each of partnership A's offices is similarly treated (the "accounting undertakings"). The accounting undertakings are controlled by the same interests, but partnerships A and B are not controlled by the same interests (within the meaning of paragraph (j) of this section). Partnership B's consulting business derives 50 percent of its gross income from customers of partnership A's accounting undertakings, but does not derive more than 20 percent of its gross income from the customers of any single accounting undertaking.

(ii) Each accounting undertaking derives more than 50 percent of its gross income from the provision of services in the field of accounting, and the consulting undertaking derives more than 50 percent of its gross income from the provision of services in the field of consulting. Thus, each accounting undertaking is treated as a professional service undertaking (within the meaning of paragraph (h)(1)(ii) of this section), and the consulting undertaking is also treated as a professional service undertaking.

(iii) Each accounting undertaking derives more than 20 percent of its gross income from services in the field of accounting. Thus, each such undertaking involves significant professional services (within the

meaning of paragraph (h)(3)(iv) of this section) in the field of accounting. In addition, all services in the field of accounting are treated as similar services under paragraph (h)(3)(i) of this section. Thus, the accounting undertakings involve the provision of significant similar services (within the meaning of paragraph (h)(3)(iii) of this section).

(iv) Paragraph (h)(2)(i) and (ii) of this section provides that a taxpayer's interests in professional service undertakings that are controlled by the same interests or that involve the provision of significant similar services are treated as part of the same activity of the taxpayer. The accounting undertakings are controlled by the same interests (see (i) above) and involve the provision of significant similar services (see (iii) above). Accordingly, the taxpayer's interests in the accounting undertakings are treated as part of the same activity under paragraph (h)(2)(i) and (ii) of this section.

(v) The consulting undertaking derives more than 20 percent of its gross income from services in the field of consulting. If, based on all the facts and circumstances, these services are determined to be similar consulting services under paragraph (h)(3)(ii) of this section, the consulting undertaking involves significant professional services (within the meaning of paragraph (h)(3)(iv) of this section). In this case, however, the consulting undertaking and the accounting undertakings do not involve the provision of significant similar services (within the meaning of paragraph (h)(3)(iii) of this section) because consulting services and accounting services are not treated as similar services under paragraph (h)(3)(i) of this section.

(vi) The consulting undertaking does not derive more than 20 percent of its gross income from the customers of any single accounting undertaking of partnership A. If, however, partnership A's accounting undertakings are aggregated, the consulting undertaking derives more than 20 percent of its gross income from customers of the aggregated undertakings. Paragraph (h)(3)(v) of this section provides that two professional service undertakings involve the provision of significant related services if more than 20 percent of the gross income of one undertaking is derived from customers of the other undertaking. For purposes of applying this rule, partnership A's accounting undertakings are treated as a single undertaking under paragraph (h)(2)(iii) of this section because the accounting undertakings are treated as part of the same activity under paragraph (h)(2)(i) and (ii) of this section. Thus, the consulting undertaking and the accounting undertakings involve the provision of significant related services.

(vii) Paragraph (h)(2)(ii) of this section provides that a taxpayer's interests in professional service undertakings that involve

the provision of significant related services are treated as part of the same activity of the taxpayer. Accordingly, the taxpayer's interests in the consulting undertaking and the accounting undertakings are treated as part of the same activity of the taxpayer under paragraph (h)(2)(ii) of this section.

Example 5. (i) The facts are the same as in Example 4, except that partnership B's consulting business derives only 15 percent of its gross income from customers of partnership A's accounting undertakings.

(ii) As in Example 4, the taxpayer's interests in the accounting undertakings are treated as part of the same activity under paragraph (h)(2)(i) and (ii) of this section and are treated under paragraph (h)(2)(iii) of this section as a single undertaking for purposes of reapplying those provisions. In this case, however, the consulting undertaking does not derive more than 20 percent of its gross income from the customers of partnership A's accounting undertakings. Thus, the consulting undertaking and the accounting undertakings do not involve the provision of significant related services. Accordingly, the accounting undertakings and the consulting undertaking are not treated as part of the same activity under paragraph (h)(2)(i) or (ii) of this section because they are not controlled by the same interests and do not involve the provision of significant similar or related services.

Example 6. (i) The taxpayer is a partner in partnerships A, B, and C. Partnership A derives substantially all of its gross income from the provision of engineering services, partnership B derives substantially all of its gross income from the provision of architectural services, and partnership C derives 40 percent of its gross income from the provision of engineering services and the remainder from the provision of architectural services. Under paragraph (c)(1) of this section, each partnership's service business is treated as a single undertaking that is separate from other undertakings. Partnerships A, B, and C are not controlled by the same interests (within the meaning of paragraph (j) of this section).

(ii) Each partnership's undertaking derives more than 50 percent of its gross income from the provision of services in the fields of architecture and engineering. Thus, each such undertaking is treated as a professional service undertaking (within the meaning of paragraph (h)(1)(ii) of this section).

(iii) Partnership A's undertaking ("undertaking A") derives more than 20 percent of its gross income from services in the field of engineering, partnership B's undertaking ("undertaking B") derives more than 20 percent of its gross income from services in the field of architecture, and partnership C's undertaking ("undertaking C") derives more than 20 percent of its gross income from services in the field of engineering and more

than 20 percent of its gross income from services in the field of architecture. Thus, undertaking A involves significant services in the field of engineering, undertaking B involves significant services in the field of architecture, and undertaking C involves significant services in both fields. Under paragraph (h)(3)(i) of this section, all services within each field are treated as similar services, but engineering services and architectural services are not treated as similar services. Thus, undertakings A and C, and undertakings B and C, involve the provision of significant similar services (within the meaning of paragraph (h)(3)(iii) of this section).

(iv) Paragraph (h)(2)(ii) of this section provides that a taxpayer's interests in professional service undertakings that involve the provision of significant similar services are treated as part of the same activity of the taxpayer. Accordingly, the taxpayer's interests in undertakings A and C are treated as part of the same activity of the taxpayer.

(v) Under paragraph (h)(2)(iii)(A) of this section, undertakings A and C are also treated as a single undertaking for purposes of determining whether undertaking B involves the provision of significant similar services. Paragraph (h)(2)(iii)(B) of this section in effect provides that treating undertakings A and C as a single undertaking does not affect the conclusion that the architectural services provided by undertakings B and C are significant similar services. Thus, undertaking B and the single undertaking in which undertakings A and C are included under paragraph (h)(3)(iii) of this section involve the provision of significant similar services, and the taxpayer's interests in undertakings A, B, and C are treated as part of the same activity of the taxpayer under paragraph (h)(2)(ii) of this section.

(i) [Reserved]

(j) *Control by the same interests and ownership percentage*—(1) *In general.* Except as otherwise provided in paragraph (j)(2) of this section, all the facts and circumstances are taken into account in determining, for purposes of this section, whether undertakings are controlled by the same interests. For this purpose, control includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of control that is determinative, and not its form or mode of exercise.

(2) *Presumption*—(i) *In general.* Undertakings are rebuttably presumed to be controlled by the same interests if such undertakings are part of the same common-ownership group.

(ii) *Common-ownership group.* Except as provided in paragraph (j)(2)(iii) of this section, two or more undertakings of a taxpayer are part of the same common-ownership group for purposes of this paragraph (j)(2) if and only if the sum of the common-ownership percentages of any five or fewer persons (within the meaning of section 7701(a)(1), but not including passthrough entities) with respect to such undertakings exceeds 50 percent. For this purpose, the common-ownership percentage of a person with respect to such undertakings is the person's smallest ownership percentage (determined in accordance with paragraph (j)(3) of this section) in any such undertaking.

(iii) *Special aggregation rule.* If, without regard to this paragraph (j)(2)(iii), an undertaking of a taxpayer is part of two or more common-ownership groups, any undertakings of the taxpayer that are part of any such common-ownership group shall be treated for purposes of this paragraph (j)(2) as part of a single common-ownership group in determining the activities of such taxpayer.

(3) *Ownership percentage*—(i) *In general.* For purposes of this section, a person's ownership percentage in an undertaking or in a passthrough entity shall include any interest in such undertaking or passthrough entity that the person holds directly and the person's share of any interest in such undertaking or passthrough entity that is held through one or more passthrough entities.

(ii) *Passthrough entities.* The following rules apply for purposes of applying paragraph (j)(3)(i) of this section:

(A) A partner's interest in a partnership and share of any interest in a passthrough entity or undertaking held through a partnership shall be determined on the basis of the greater of such partner's percentage interest in the capital (by value) of such partnership or such partner's largest distributive share of any item of income or gain (disregarding guaranteed payments under section 707(c)) of such partnership.

(B) A shareholder's interest in an S corporation and share of any interest in a passthrough entity or undertaking held through an S corporation shall be

determined on the basis of such shareholder's stock ownership.

(C) A beneficiary's interest in a trust or estate and share of any interest in a passthrough entity or undertaking held through a trust or estate shall not be taken into account.

(iii) *Attribution rules*—(A) *In general.* Except as otherwise provided in paragraph (j)(3)(iii)(B) of this section, a person's ownership percentage in a passthrough entity or in an undertaking shall be determined by treating such person as the owner of any interest that a person related to such person owns (determined without regard to this paragraph (j)(3)(iii)) in such passthrough entity or in such undertaking.

(B) *Determination of common-ownership percentage.* The common-ownership percentage of five or fewer persons with respect to two or more undertakings shall be determined, in any case in which, after the application of paragraph (j)(3)(iii)(A) of this section, two or more such persons own the same interest in any such undertaking (the "related-party owners") by treating as the only owner of such interest (or portion thereof) the related-party owner whose ownership of such interest (or a portion thereof) would result in the highest common-ownership percentage.

(C) *Related person.* A person is related to another person for purposes of this paragraph (j)(3)(iii) if the relationship of such persons is described in section 267(b) or 707(b)(1).

(4) *Special rule for trade or business activities.* In determining whether two or more trade or business activities are controlled by the same interests for purposes of paragraph (g) of this section, each such activity shall be treated as a separate undertaking in applying this paragraph (j).

(5) *Examples.* The following examples illustrate the application of this paragraph (j):

Example 1. (i) Partnership X is the sole owner of an undertaking (undertaking X), and partnership Y is the sole owner of another undertaking (undertaking Y). Individuals A, B, C, D, and E are the only partners in partnerships X and Y, and the partnership agreements of both X and Y provide that no action may be taken or decision made on behalf of the partnership without the unanimous consent of the partners. Moreover, each partner actually participates in, and

agrees to, all major decisions that affect the operations of either partnership. The ownership percentages (within the meaning of paragraph (j)(3) of this section) of A, B, C, D, and E in each partnership (and in the undertaking owned by the partnership) are as follows:

Partner	PARTNERSHIP/UNDERTAKING	
	X (percent)	Y (percent)
A	15	5
B	10	60
C	10	20
D	77	12
E	8	20
.....	120	117

The sum of the ownership percentages exceeds 100 percent for both X and Y because, under paragraph (j)(3)(ii)(A) of this section, each partner's ownership percentage is determined on the basis of the greater of the partner's percentage interest in the capital of the partnership or the partner's largest distributive share of any item of income or gain of the partnership.

(ii) Paragraph (j)(2)(ii) of this section provides that a person's common-ownership percentage with respect to any two or more undertakings is the person's smallest ownership percentage in any such undertaking. Thus, the common-ownership percentages of A, B, C, D, and E with respect to undertakings X and Y are as follows:

Partner	Common-ownership percentage
A	5
B	10
C	10
D	12
E	8
.....	45

(iii) Paragraph (j)(2)(i) of this section provides that undertakings are rebuttably presumed to be controlled by the same interests if the undertakings are part of the same common-ownership group. In general, undertakings are part of a common-ownership group only if the sum of the common-ownership percentages of any five or fewer persons with respect to such undertakings exceeds 50 percent. In this case, the sum of the partners' common-ownership percentages with respect to undertakings X and Y is only 45 percent. Thus, undertakings X and Y are not part of the same common-ownership group.

(iv) If the presumption in paragraph (j)(2)(i) of this section does not apply, all the facts and circumstances are taken into account in determining whether undertakings are controlled by the same interests (see paragraph (j)(1) of this section). In this case,

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all actions and decisions in both undertakings require the unanimous consent of the same persons and each of those persons actually participates in, and agrees to, all major decisions. Accordingly, undertakings X and Y are controlled by the same interests (i.e., A, B, C, D, and E).

Example 2. (i) Partnerships W, X, Y, and Z are each the sole owner of an undertaking (undertakings W, X, Y, and Z). Individuals A, B, and C are partners in each of the four partnerships, and the remaining interests in each partnership are owned by a number of unrelated individuals, none of whom owns more than a one-percent interest in any of the partnerships. The ownership percentages (within the meaning of paragraph (j)(3) of this section) of A, B, and C in each partnership (and in the undertaking owned by the partnership) are as follows:

Partnership/Undertaking	Partner		
	A	B	C
W	23%	21%	40%
X	19%	30%	22%
Y	25%	25%	20%
Z	8%	4%	2%

(ii) Paragraph (j)(2)(ii) of this section provides that a person's common-ownership percentage with respect to any two or more undertakings is the person's smallest ownership percentage in any such undertaking. Thus, the common-ownership percentages of A, B, and C in undertakings W, X, Y, and Z are as follows:

Partner	Common-ownership percentage
A	8
B	4
C	2
	14

(iii) The sum of the common-ownership percentages of A, B, and C with respect to undertakings W, X, Y, and Z is 14 percent, and no other person owns more than a one-percent interest in any of the undertakings. Thus, the sum of the common-ownership percentages of any five or fewer persons with respect to all four undertakings cannot exceed 50 percent. Accordingly, undertakings W, X, Y, and Z are not part of the same common-ownership group (see paragraph (j)(2)(ii) of this section) and are not rebuttably presumed to be controlled by the same interests (see paragraph (j)(2)(i) of this section).

(iv) The common-ownership percentages of A, B, and C in undertakings W, X, and Y are as follows:

Partner	Common ownership percentage
A	19

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Partner	Common ownership percentage
B	21
C	20
	60

(v) The sum of the common-ownership percentages of A, B, and C, taking into account only undertakings W, X, and Y, is 60 percent. Because the sum of the common-ownership percentages exceeds 50 percent, undertakings W, X, and Y are part of the same common-ownership group (see paragraph (j)(2)(ii) of this section and are rebuttably presumed to be controlled by the same interests (see paragraph (j)(2)(i) of this section).

Example 3. (i) Corporation X, an S corporation, is the sole owner of an undertaking (undertaking X), and corporation Y, another S corporation, is the sole owner of another undertaking (undertaking Y). Individuals A, B, and C are shareholders in corporations X and Y. Both A and B are related (within the meaning of paragraph (j)(3)(iii)(C) of this section) to C, but not to each other. A, B, and C are not related to any other person that owns an interest in either corporation X or corporation Y. The ownership percentages (determined without regard to the attribution rules of paragraph (j)(3)(iii) of this section) of A, B, and C in each corporation (and in the undertaking owned by the corporation) are as follows:

CORPORATION/UNDERTAKING

Shareholder	X (percent)	Y (percent)
A	20
B	20
C	5	5

(ii) In general, a person's ownership percentage is determined by treating the person as the owner of interests that are actually owned by related persons (see paragraph (j)(3)(iii)(A) of this section). If A, B, and C are treated as owning interests that are actually owned by related persons, their ownership percentages are as follows:

CORPORATION/UNDERTAKING

Shareholder	X (percent)	Y (percent)
A	25	5
B	5	25
C	25	25

(iii) Paragraph (j)(3)(iii)(B) of this section provides that, in determining the sum of the common-ownership percentages of any five or fewer persons with respect to any undertakings, each interest in such undertakings is counted only once. If two or more persons are treated as owners of the same interest under paragraph (j)(3)(iii)(A) of this section,

the person whose ownership would result in the highest sum is treated as the only owner of the interest. In this case, C's common-ownership percentage with respect to undertakings X and Y, determined by treating C as the owner of the interests actually owned by A and B, is 25 percent. If, however, A and B are treated as the owners of the interests actually owned by C, each has a common-ownership percentage of only five percent. Thus, in determining the sum of common-ownership percentages with respect to undertakings X and Y, C is treated as the owner of the interests actually owned by A and B because this treatment results in the highest sum of common-ownership percentages with respect to such undertakings.

Example 4. (i) The ownership percentages of individuals A, B, and C in undertakings X, Y, and Z are as follows:

UNDERTAKING			
Individual	X	Y	Z
A	30%	30%	30%
B	30%	30%	30%
C		30%	30%

No other person owns an interest in more than one of the undertakings.

(ii) Paragraph (j)(2)(ii) of this section provides that a person's common ownership percentage with respect to any two or more undertakings is the person's smallest ownership percentage in any such undertaking. Thus, A's common-ownership percentage with respect to undertakings X, Y, and Z is 30 percent, and the common-ownership percentages of B and C (and all other persons owning interests in such undertakings) with respect to such undertakings is zero. Accordingly, the sum of the common ownership percentages with respect to undertakings X, Y, and Z is only 30 percent, and undertakings X, Y, and Z are not treated as part of the same common-ownership group under paragraph (j)(2)(ii) of this section.

(iii) B's common-ownership percentage with respect to undertakings X and Y is 30 percent, and the sum of A's and B's common-ownership percentages with respect to such undertakings is 60 percent. Thus, undertakings X and Y are treated as part of the same common-ownership group under paragraph (j)(2)(ii) of this section. Similarly, C's common-ownership percentage with respect to undertakings Y and Z is 30 percent, and the sum of A's and C's common-ownership percentages with respect to such undertakings is 60 percent. Thus, undertakings Y and Z are also treated as part of the same common-ownership group under paragraph (j)(2)(ii) of this section.

(iv) Paragraph (j)(2)(iii) of this section requires the aggregation of common-ownership groups that include the same undertaking.

In this case, undertaking Y is treated as part of the common-ownership group XY and as part of the common-ownership group YZ. Accordingly, undertakings X, Y, and Z are treated as part of a single common-ownership group and are rebuttably presumed to be controlled by the same interests (see paragraph (j)(2)(i) of this section) even though B does not own an interest in undertaking Z and C does not own an interest in undertaking X. The fact that B and C are not common owners with respect to undertakings X and Z is taken into account, however, in determining whether this presumption is rebutted.

(k) *Identification of rental real estate activities*—(1) *Applicability*—(i) *In general.* Except as otherwise provided in paragraph (k)(6) of this section, this paragraph (k) applies to a taxpayer's interests in rental real estate undertakings (within the meaning of paragraph (k)(1)(ii) of this section).

(ii) *Rental real estate undertaking.* For purposes of this paragraph (k), a rental real estate undertaking is a rental undertaking (within the meaning of paragraph (d) of this section) in which at least 85 percent of the unadjusted basis (within the meaning of § 1.469-2T(f)(3)) of the property made available for use by customers is real property. For this purpose the term "real property" means any tangible property other than tangible personal property (within the meaning of § 1.48-1(c)).

(2) *Identification of activities*—(i) *Multiple undertakings treated as a single activity or multiple activities by taxpayer.* Except as otherwise provided in this paragraph (k), a taxpayer may treat two or more rental real estate undertakings (determined after the application of paragraph (k)(2)(ii) and (iii) of this section) as a single activity or may treat such undertakings as separate activities.

(ii) *Multiple undertakings treated as a single activity by passthrough entity.* A taxpayer must treat two or more rental real estate undertakings as a single rental real estate undertaking for a taxable year if any passthrough entity through which the taxpayer holds such undertakings treats such undertakings as a single activity on the applicable return of the passthrough entity for the taxable year of the taxpayer.

(iii) *Single undertaking treated as multiple undertakings.* Notwithstanding

that a taxpayer's interest in leased property would, but for the application of this paragraph (k)(2)(iii), be treated as used in a single rental real estate undertaking, the taxpayer may, except as otherwise provided in paragraph (k)(3) of this section, treat a portion of the leased property (including a ratable portion of any common areas or facilities) as a rental real estate undertaking that is separate from the undertaking or undertakings in which the remaining portion of the property is treated as used. This paragraph (k)(2)(iii) shall apply for a taxable year if and only if—

(A) Such portion of the leased property can be separately conveyed under applicable State and local law (taking into account the limitations, if any, imposed by any special rules or procedures, such as condominium conversion laws, restricting the separate conveyance of parts of the same structure); and

(B) The taxpayer holds such leased property directly or through one or more passthrough entities, each of which treats such portion of the leased property as a separate activity on the applicable return of the passthrough entity for the taxable year of the taxpayer.

(3) *Treatment in succeeding taxable years.* All rental real estate undertakings or portions of such undertakings that are treated, under this paragraph (k), as part of the same activity for a taxable year ending after August 9, 1989 must be treated as part of the same activity in each succeeding taxable year.

(4) *Applicable return of passthrough entity.* For purposes of this paragraph (k), the applicable return of a passthrough entity for a taxable year of a taxpayer is the return reporting the passthrough entity's income, gain, loss, deductions, and credits taken into account by the taxpayer for such taxable year.

(5) *Evidence of treatment required.* For purposes of this paragraph (k), a person (including a passthrough entity) does not treat a rental real estate undertaking as multiple undertakings for a taxable year or, except as otherwise provided in paragraph (k) (2)(ii) or (3) of this section, treat multiple rental real estate undertakings as a single un-

dertaking for a taxable year unless such treatment is reflected on a schedule attached to the person's return for the taxable year.

(6) *Coordination rule for rental of non-depreciable property.* This paragraph (k) shall not apply to a rental real estate undertaking if less than 30 percent of the unadjusted basis (within the meaning of § 1.469-2T(f)(3)) of property used or held for use by customers in such undertaking during the taxable year is subject to the allowance for depreciation under section 167.

(7) *Coordination rule for rental of dwelling unit.* For any taxable year in which section 280A(c)(5) applies to a taxpayer's use of a dwelling unit—

(i) Paragraph (k) (2) and (3) of this section shall not apply to the taxpayer's interest in such dwelling unit; and

(ii) The taxpayer's interest in such dwelling unit shall be treated as a separate activity of the taxpayer.

(8) *Examples.* The following examples illustrate the application of this paragraph (k). In each example, the taxpayer is an individual whose taxable year is the calendar year.

Example 1. (i) In 1989, the taxpayer directly owns five condominium units (units A, B, C, D, and E) in three different buildings. Units A, B, and C are in one of the buildings and constitute a single rental real estate undertaking (within the meaning of paragraph (k)(1)(ii) of this section). Units D and E are in the other two buildings, and each of these units constitutes a separate rental real estate undertaking. Each of the units can be separately conveyed under applicable State and local law.

(ii) Paragraph (k)(2)(iii) of this section permits a taxpayer to treat a portion of the property included in a rental real estate undertaking as a separate rental real estate undertaking if the property can be separately conveyed under applicable State and local law and the taxpayer owns the property directly. Thus, the taxpayer can treat units A, B, and C as three separate undertakings. Alternatively, the taxpayer could treat two of those units (*e.g.*, units A and C) as an undertaking and the remaining unit as a separate undertaking, or could treat units A, B, and C as a single undertaking.

(iii) Paragraph (k)(2)(i) of this section permits a taxpayer to treat two or more rental real estate undertakings as a single activity, or to treat such undertakings as separate activities. Thus, the taxpayer, by combining undertakings, can treat all five units as a

single activity. Alternatively, the taxpayer could treat each undertaking as a separate activity, or could combine some, but not all, undertakings. Thus, for example, the taxpayer could treat units A, B, C, and D as an activity and unit E as a separate activity.

(iv) For purposes of paragraph (k)(2)(i) of this section, a taxpayer's rental real estate undertakings are determined after the application of paragraph (k)(2)(iii) of this section. Thus, the taxpayer, by treating units as separate undertakings under paragraph (k)(2)(iii) of this section and combining them with other units under paragraph (k)(2)(i) of this section, can treat any combination of units as a single activity. For example, the taxpayer could treat units A and B as a separate rental real estate undertaking, and then treat units A, B, and D as a single activity. In that case, the taxpayer could treat units C and E either as a single activity or as two separate activities.

Example 2. (i) The facts are the same as in Example 1. In addition, the taxpayer treats all five units as a single activity for 1989 and sells unit E in 1990. (See paragraph (k)(5) of this section for a rule providing that the units are treated as a single activity only if such treatment is reflected on a schedule attached to the taxpayer's return.)

(ii) Under paragraph (k)(3) of this section, rental real estate undertakings that are treated as part of the same activity for a taxable year must be treated as part of the same activity in each succeeding year. In this case, all five units were treated as part of the same activity for 1989 and must therefore be treated as part of the same activity for 1990. Accordingly, the taxpayer's sale of unit E in 1990 cannot be treated as a disposition of the taxpayer's entire interest in an activity for purposes of section 469(g) and the rules to be contained in § 1.469-6T (relating to the treatment of losses upon certain dispositions of passive and former passive activities).

Example 3. (i) The facts are the same as in Example 1, except that the taxpayer is a partner in a partnership that is the direct owner of the five condominium units. In its return for its taxable year ending on November 30, 1989, the partnership treats the five units as a single activity. (See paragraph (k)(5) of this section for a rule providing that the units are treated as a single activity only if such treatment is reflected on a schedule attached to the partnership's return.) The partnership sells unit E on November 1, 1990.

(ii) Paragraph (k)(2)(ii) of this section provides that a taxpayer who holds rental real estate undertakings through a passthrough entity must treat those undertakings as a single rental real estate undertaking if they are treated as a single activity on the applicable return of the passthrough entity. Under paragraph (k)(4) of this section, the

applicable return of the partnership for the taxpayer's 1989 taxable year is the partnership's return for its taxable year ending on November 30, 1989. Accordingly, the taxpayer must treat the five condominium units as a single rental real estate undertaking (and thus as part of the same activity) for 1989 because they are treated as a single activity on the partnership's return for its taxable year ending in 1989.

(iii) Under paragraph (k)(3) of this section, the taxpayer must continue treating the condominium units as part of the same activity for taxable years after 1989. Accordingly, as in Example 2, the five condominium units are treated as part of the same activity for 1990, and the sale of unit E in 1990 cannot be treated as a disposition of the taxpayer's interest in an activity for purposes of section 469(g) and the rules to be contained in § 1.469-6T.

Example 4. (i) The taxpayer owns a shopping center and a vacant lot that are separate rental real estate undertakings (within the meaning of paragraph (k)(1)(ii) of this section). The taxpayer rents space in the shopping center to various tenants and rents the vacant lot to a parking lot operator. Most of the unadjusted basis of the property used in the shopping-center undertaking (taking into account the land on which the shopping center is built) is subject to the allowance for depreciation, but no depreciable property is used in the parking-lot undertaking.

(ii) This paragraph (k) provides rules for identifying rental real estate activities (including the rule in paragraph (k)(2)(i) of this section that permits a taxpayer to treat two or more rental real estate undertakings as a single activity). Paragraph (k)(6) of this section provides, however, that these rules do not apply to a rental real estate undertaking if less than 30 percent of the unadjusted basis of the property used in the undertaking is subject to the allowance for depreciation. Thus, the taxpayer may not combine the parking-lot undertaking, which includes no depreciable property, with the shopping-center undertaking or any other rental real estate undertaking under paragraph (k)(2)(i) of this section. Accordingly, the parking lot undertaking is treated as a separate activity under paragraph (b)(1) of this section.

Example 5. (i) The facts are the same as in Example 4, except that the shopping center and the vacant lot are at the same location (within the meaning of paragraph (c)(2)(iii) of this section) and are part of the same rental real estate undertaking (within the meaning of paragraph (k)(1)(ii) of this section). Taking into account the property used in the shopping center operations (including the land on which the shopping center is built) and the vacant lot, 50 percent of the unadjusted basis of the property used in the

undertaking is subject to the allowance for depreciation.

(ii) In this case, the vacant lot is used in a rental real estate undertaking in which depreciable property is also used. Moreover, the exception in paragraph (k)(6) of this section does not apply to the undertaking consisting of the shopping center and the parking lot because at least 30 percent of unadjusted basis of the property used in the undertaking is subject to the allowance for depreciation. Accordingly, the taxpayer may combine the undertaking with other rental real estate undertakings and treat the combined undertakings as a single activity under paragraph (k)(2)(i) of this section.

(1) [Reserved]

(m) *Consolidated groups*—(1) *In general*. The activities of a consolidated group (within the meaning of § 1.469-1T(h)(2)(ii)) and of each member of such group shall be determined under this section as if the consolidated group were one taxpayer.

(2) *Examples*. The following examples illustrate the application of this paragraph (m). In each example, the facts, analysis, and conclusions relate to a single taxable year.

Example 1. (i) Corporations M, N, and O are the members of a consolidated group (within the meaning of § 1.469-1T(h)(2)(ii)). Under § 1.469-1T(h)(4)(i)(A) and (ii), the consolidated group and its members are treated as closely held corporations (within the meaning of § 1.469-1T(g)(2)(ii)). Each member of the consolidated group owns a two-percent interest in partnership X and a two-percent interest in partnership Y, and owns interests in a number of trade or business undertakings (within the meaning of paragraph (f)(1)(ii) of this section) through the partnerships. Each of these undertakings is directly owned by partnership X or Y, and all the undertakings of partnerships X and Y are controlled by the same interests (within the meaning of paragraph (j) of this section) and are similar (within the meaning of paragraph (f)(4) of this section). The employees of the consolidated group and the shareholders of its common parent do not participate in the undertakings that the member corporations own through the partnerships.

(ii) Paragraph (f)(2)(i) of this section provides that trade or business undertakings that are similar and controlled by the same interests are treated as part of the same activity of the taxpayer if the taxpayer owns interests in the undertakings through the same passthrough entity. In this case, the member corporations own interests in similar, commonly-controlled undertakings through both partnerships, and such interests are treated under this paragraph (m) as

interests owned by one taxpayer (the consolidated group). Accordingly, the member corporations' interests in the undertakings owned through partnership X are treated as part of the same activity of the consolidated group, and their interests in the undertakings owned through partnership Y are treated similarly.

Example 2. (i) The facts are the same as in Example 1, except that each member of the consolidated group owns a five-percent interest in partnership X and a five-percent interest in partnership Y.

(ii) Paragraph (f)(2)(ii) of this section provides that trade or business undertakings that are similar and controlled by the same interests are treated as part of the same activity of the taxpayer if the taxpayer owns a direct or substantial indirect interest in each such undertaking. In this case, the member corporations own, in the aggregate, a 15-percent interest in partnership X and a 15-percent interest in partnership Y, and such interests are treated under this paragraph (m) as interests owned by one taxpayer (the consolidated group). Thus, the consolidated group owns a substantial indirect interest in the similar, commonly-controlled undertakings owned by partnerships X and Y (see paragraph (f)(3)(i) of this section). Accordingly, the member corporations' interests in the undertakings owned through partnerships X and Y are treated as part of the same activity of the consolidated group.

(n) *Publicly traded partnerships*. The rules of this section shall apply to a taxpayer's interest in business and rental operations held through a publicly traded partnership (within the meaning of section 469(k)(2)) as if the taxpayer had no interest in any other business and rental operations. The following example illustrates the application of this paragraph (n):

Example. (i) The taxpayer, an individual, owns a 20-percent interest in partnership X and a 15-percent interest in partnership Y. Partnership X directly owns a hotel ("hotel 1") and a commercial office building ("building 1"). Partnership Y directly owns two hotels ("hotels 2 and 3") and two commercial office buildings ("buildings 2 and 3"). Each of the three hotels is a separate trade or business undertaking (within the meaning of paragraph (f)(1)(ii) of this section), and each of the three office buildings is a separate rental real estate undertaking (within the meaning of paragraph (k)(1)(ii) of this section). The three hotel undertakings are similar (within the meaning of paragraph (f)(4) of this section) and are controlled by the same interests (within the meaning of paragraph (j) of this section). Partnership X

is not a publicly traded partnership (within the meaning of section 469(k)(2)). Partnership Y, however, is a publicly traded partnership and is not treated as a corporation under section 7704.

(ii) This paragraph (n) provides that the rules of this section apply to a taxpayer's interest in business and rental operations held through a publicly traded partnership as if the taxpayer had no interest in any other business and rental operations. Thus, undertakings owned through partnership Y may be treated as part of the same activity under the rules of this section, but an undertaking owned through partnership Y and an undertaking that is not owned through partnership Y may not be treated as part of the same activity.

(iii) Paragraph (f)(2)(i) of this section provides that a taxpayer's interests in two or more trade or business undertakings that are similar and controlled by the same interests are treated as part of the same activity if the taxpayer owns interests in each undertaking through the same passthrough entity. Partnership Y's hotel undertakings (*i.e.*, hotels 2 and 3) are similar and are controlled by the same interests. In addition, the taxpayer owns interests in both undertakings through the same partnership. Accordingly, the taxpayer's interests in partnership Y's hotel undertakings are treated as part of the same activity.

(iv) The hotel undertaking owned through partnership X (*i.e.*, hotel 1) and the hotel undertakings owned through partnership Y are similar and controlled by the same interests, and the taxpayer owns a substantial indirect interest in each of the undertakings (see paragraph (f)(3)(i) of this section). Thus, the three undertakings would ordinarily be treated as part of the same activity under paragraph (f)(2)(ii) of this section. Under this paragraph (n), however, undertakings that are owned through a publicly traded partnership cannot be treated as part of the same activity as any undertaking not owned through that partnership. Accordingly, the hotel undertaking that the taxpayer owns through partnership X and the hotel undertakings that the taxpayer owns through partnership Y are treated as two separate activities.

(v) Paragraph (k)(2)(i) of this section provides that, with certain exceptions, a taxpayer may treat two or more rental real estate undertakings as a single activity or as separate activities. Thus, the taxpayer's interests in the rental real estate undertakings owned through partnership Y (*i.e.*, buildings 2 and 3) may be treated as a single activity or as separate activities. Under this paragraph (n), however, undertakings that are owned through a publicly traded partnership cannot be treated as part of the same activity as any undertaking not owned through that partnership. Accordingly, the tax-

payer's interest in the rental real estate undertaking owned through partnership X (building 1) cannot be treated as part of an activity that includes any rental real estate undertaking owned through partnership Y.

(o) *Elective treatment of undertakings as separate activities*—(1) *Applicability*. This paragraph applies to a taxpayer's interest in any undertaking (other than a rental real estate undertaking (within the meaning of paragraph (k)(1)(ii) of this section)) that would otherwise be treated under this section as part of an activity that includes the taxpayer's interest in any other undertaking.

(2) *Undertakings treated as separate activities*. Except as otherwise provided in this paragraph (o), a person (including a passthrough entity) shall treat an undertaking to which this paragraph (o) applies as an activity separate from the remainder of the activity in which such undertaking would otherwise be included for a taxable year if and only if, for such taxable year or any preceding taxable year, such person made an election with respect to such undertaking under this paragraph (o).

(3) *Multiple undertakings treated as a single activity by passthrough entity*. A person (including a passthrough entity) must treat interests in two or more undertakings as part of the same activity for a taxable year if any passthrough entity through which the person holds such undertakings treats such undertakings as part of the same activity on the applicable return of the passthrough entity for the taxable year of such person.

(4) *Multiple undertakings treated as a single activity for a preceding taxable year*. If a person (including a passthrough entity) treats undertakings as part of the same activity on such person's return for a taxable year ending after August 9, 1989, such person may not treat such undertakings as part of different activities under this paragraph (o) for any subsequent taxable year.

(5) *Applicable return of passthrough entity*. For purposes of this paragraph (o), the applicable return of a passthrough entity for a taxable year of a taxpayer is the return reporting the passthrough entity's income, gain, loss, deductions,

and credits taken into account by the taxpayer for such taxable year.

(6) *Participation.* The following rules apply to multiple activities (the “separate activities”) that would be treated as a single activity (the “original activity”) if the taxpayer’s activities were determined without regard to this paragraph (o):

(i) The taxpayer shall be treated as materially participating (within the meaning of § 1.469-5T) for the taxable year in the separate activities if and only if the taxpayer would, but for the application of this paragraph (o), be treated as materially participating for the taxable year in the original activity.

(ii) The taxpayer shall be treated as significantly participating (within the meaning of § 1.469-5T(c)(2)) for the taxable year in the separate activities if and only if the taxpayer would, but for the application of this paragraph (o), be treated as significantly participating for the taxable year in the original activity.

(7) *Election*—(i) *In general.* A person makes an election with respect to an undertaking under this paragraph (o) by attaching the written statement described in paragraph (o)(7)(ii) of this section to such person’s return for the taxable year for which the election is made (see paragraph (o)(2) of this section).

(ii) *Written statement.* The written statement required by paragraph (o)(7)(i) of this section must—

(A) State the name, address, and taxpayer identification number of the person making the election;

(B) Contain a declaration that an election is being made under § 1.469-4T(o);

(C) Identify the undertaking with respect to which such election is being made; and

(D) Identify the remainder of the activity in which such undertaking would otherwise be included.

(8) *Examples.* The following examples illustrate the application of this paragraph (o):

Example 1. (i) During 1989, the taxpayer, an individual whose taxable year is the calendar year, acquires and is the direct owner of ten grocery stores. The operations of each grocery store are treated under paragraph (c)(1)

of this section as a single undertaking that is separate from other undertakings (a “grocery-store undertaking”), and the taxpayer’s interests in the grocery-store undertakings would be treated as part of the same activity of the taxpayer under paragraph (f)(2) of this section.

(ii) Paragraph (o)(2) of this section provides that, with certain exceptions, undertakings that would be treated as part of the same activity under other rules in this section may, at the election of the taxpayer, be treated as separate activities. Thus, the taxpayer may elect to treat each grocery-store undertaking as a separate activity for 1989. Alternatively, the taxpayer may combine grocery-store undertakings in any manner and treat each combination of undertakings (and each uncombined undertaking) as a separate activity for 1989. In either case, the election must be made by attaching the written statement described in paragraph (o)(7)(ii) of this section to the taxpayer’s 1989 return.

Example 2. (i) The facts are the same as in Example 1. In addition, the taxpayer, in 1989, elects to treat each grocery-store undertaking as a separate activity and participates for 15 hours in each of the grocery-store undertakings.

(ii) The taxpayer’s interest in each grocery-store undertaking is treated, under paragraph (o)(2) of this section, as a separate activity of the taxpayer for 1989 (a “grocery-store activity”). In 1989, however, the taxpayer participates for more than 100 hours in the activity in which the undertakings would be included (but for the election to treat the grocery-store undertakings as separate activities) and would be treated under § 1.469-5T(c)(2) as significantly participating in such activity. Accordingly, the taxpayer is treated under paragraph (o)(6)(ii) of this section as significantly participating in each of the grocery-store activities for 1989.

Example 3. (i) The facts are the same as in Example 1. In addition, the taxpayer, in 1989, elects to treat each grocery-store undertaking as a separate activity. The taxpayer does not participate in any of the grocery-store undertakings in 1989 or 1990, and sells one of the grocery stores in 1990.

(ii) As in Example 2, the taxpayer’s interests in each grocery-store undertaking is treated, under paragraph (o)(2) of this section, as a separate activity of the taxpayer for 1989. Because the taxpayer elected to treat the undertakings as separate activities for a preceding taxable year (1989), each grocery-store undertaking is also treated, under paragraph (o)(2) of this section, as a separate activity of the taxpayer for 1990. In addition, each of the taxpayer’s grocery-store activities is a passive activity for 1989 and 1990 because the taxpayer does not participate in any of the grocery store undertakings for 1989 and 1990. Accordingly, the taxpayer’s

sale of the grocery store will generally be treated as a disposition of the taxpayer's entire interest in a passive activity for purposes of section 469(g) and the rules to be contained in § 1.469-6T (relating to the treatment of losses upon certain dispositions of passive and former passive activities).

Example 4. (i) The facts are the same as in Example 3, except that the taxpayer elects to treat the grocery-store undertakings as two separate activities. One of the activities includes three grocery-store undertakings, and the store sold in 1990 is part of this activity. The other activity includes the seven remaining grocery-store undertakings.

(ii) Paragraph (o)(4) of this section provides that a person who treats undertakings as part of the same activity for a taxable year ending after August 9, 1989, may not elect to treat those undertakings as separate activities for a subsequent taxable year. The grocery store sold in 1990 was treated for 1989 as part of an activity that includes two other grocery stores. Thus, those three stores must be treated as part of the same activity for 1990. Accordingly, the taxpayer's sale of the grocery store cannot be treated as a disposition of the taxpayer's entire interest in a passive activity for purposes of section 469(g) and the rules to be contained in § 1.469-6T.

Example 5. (i) The facts are the same as in Example 1, except that the taxpayer is a partner in a partnership that acquires and is the direct owner of the ten grocery stores. The taxable year of the partnership ends on November 30, and the partnership acquires the grocery stores in its taxable year ending on November 30, 1989. In its return for that taxable year, the partnership treats the grocery-store undertakings as a single activity.

(ii) Paragraph (o)(3) of this section provides that a person who holds undertakings through a passthrough entity may not elect to treat those undertakings as separate activities if they are treated as part of the same activity on the applicable return of the passthrough entity. Under paragraph (o)(5) of this section, the applicable return of the partnership for the taxpayer's 1989 taxable year is the partnership's return for its taxable year ending on November 30, 1989. Accordingly, the taxpayer must treat the grocery-store undertakings as a single activity for 1989 because those undertakings are treated as a single activity on the partnership's return for its taxable year ending in 1989.

(iii) Under paragraph (o)(4) of this section, the taxpayer must continue treating the grocery-store undertakings as part of the same activity for taxable years after 1989. This rule applies even if the partnership subsequently distributes its interest in the grocery stores to the taxpayer, and the taxpayer becomes the direct owner of the grocery-store undertakings.

(p) Special rule for taxable years ending before August 10, 1989—(1) *In general.* For purposes of applying section 469 and the regulations thereunder for a taxable year ending before August 10, 1989, a taxpayer's business and rental operations may be organized into activities under the rules or paragraphs (b) through (n) of this section or under any other reasonable method. For example, for such taxable years a taxpayer may treat each of the taxpayer's undertakings as a separate activity, or a taxpayer may treat undertakings that involve the provision of similar goods or services as a single activity.

(2) *Unreasonable methods.* A method of organizing business and rental operations into activities is not reasonable if such method—

(i) Treats rental operations (within the meaning of paragraph (d)(3) of this section) that are not ancillary to a trade or business activity (within the meaning of § 1.469-1T(e)(2)) as part of a trade or business activity;

(ii) Treats operations that are not rental operations and are not ancillary to a rental activity (within the meaning of § 1.469-1T(e)(3)) as part of a rental activity;

(iii) Includes in a passive activity of a taxpayer any oil or gas well that would be treated, under paragraph (e)(1) of this section, as a separate undertaking in determining the taxpayer's activities;

(iv) Includes in a passive activity of a taxpayer any interest in a dwelling unit that would be treated, under paragraph (K)(7) of this section, as a separate activity of the taxpayer; or

(v) Is inconsistent with the taxpayer's method of organizing business and rental operations into activities for the taxpayer's first taxable year beginning after December 31, 1986.

(3) *Allocation of disallowed deductions in succeeding taxable year.* If any of the taxpayer's passive activity deductions or the taxpayer's credits from passive activities are disallowed under § 1.469-1T for the last taxable year of the taxpayer ending before August 10, 1989, such disallowed deductions or credits shall be allocated among the taxpayer's activities for the first taxable

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year of the taxpayer ending after August 9, 1989, using any reasonable method. See § 1.469-1T(f)(4).

[T.D. 8253, 54 FR 20542, May 12, 1989]

§ 1.469-5 Material participation.

(a)-(e) [Reserved]

(f) *Participation*—(1) *In general.* Except as otherwise provided in this paragraph (f), any work done 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 done shall be treated for purposes of this section as participation of the individual in the activity.

(f)(2)–(h)(2) [Reserved]

(h)(3) *Coordination with rules governing the treatment of passthrough entities.* If a taxpayer takes into account for a taxable year of the taxpayer any item of gross income or deduction from a partnership or S corporation that is characterized as an item of gross income or deduction from an activity in which the taxpayer materially participated under § 1.469-2T(e)(1), the taxpayer is treated as materially participating in the activity for the taxable year for purposes of applying § 1.469-5T(a)(5) and (6) to any succeeding taxable year of the taxpayer.

(i) [Reserved]

(j) *Material participation for preceding taxable years*—(1) *In general.* For purposes of § 1.469-5T(a)(5) and (6), a taxpayer has materially participated in an activity for a preceding taxable year if the activity includes significant section 469 activities that are substantially the same as significant section 469 activities that were included in an activity in which the taxpayer materially participated (determined without regard to § 1.469-5T(a)(5)) for the preceding taxable year.

(2) *Material participation for taxable years beginning before January 1, 1987.* In any case in which it is necessary to determine whether an individual materially participated in any activity for a taxable year beginning before January 1, 1987 (other than a taxable year of a partnership, S corporation, estate, or trust ending after December 31, 1986), the determination shall be made without regard to paragraphs (a)(2) through (7) of this section.

(k) *Examples.* Example 1—Example 4 [Reserved]

Example 5. In 1993, D, an individual, acquires stock in an S corporation engaged in a trade or business activity (within the meaning of § 1.469-1(e)(2)). For every taxable year from 1993 through 1997, D is treated as materially participating (without regard to § 1.469-5T(a)(5)) in the activity. D retires from the activity at the beginning of 1998, and would not be treated as materially participating in the activity for 1998 and subsequent taxable years if material participation of those years were determined without regard to § 1.469-5T(a)(5). Under § 1.469-5T(a)(5) of this section, however, D is treated as materially participating in the activity for taxable years 1998 through 2003 because D materially participated in the activity (determined without regard to § 1.469-5T(a)(5) for five taxable years during the ten taxable years that immediately precede each of those years. D is not treated under § 1.469-5T(a)(5) as materially participating in the activity for taxable years beginning after 2003 because for those years D has not materially participated in the activity (determined without regard to § 1.469-5T(a)(5) for five of the last ten immediately preceding taxable years.

[T.D. 8417, 57 FR 20758, May 15, 1992]

§ 1.469-5T Material participation (temporary).

(a) *In general.* Except as provided in paragraphs (e) and (h)(2) of this section, an individual shall be treated, for purposes of section 469 and the regulations thereunder, as materially participating in an activity for the taxable year if and only if—

(1) The individual participates in the activity for more than 500 hours during such year;

(2) The individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all 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 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;