STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CLAUDEL CHERY	:	DETERMINATION DTA NO. 825699
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2008.	:	

Petitioner, Claudel Chery, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the year 2008.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, in New York, New York, on August 27, 2014, at 10:30 A.M., with all briefs due by March 9, 2015. The three-month extension allowed by Tax Law § 2010(3) was invoked on September 3, 2015. Petitioner appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Kent J. Gebert, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly denied petitioner's status as a real estate professional, thereby limiting or disallowing his 2008 Schedule E rental losses from two rental properties located in Brooklyn and Middletown, New York, pursuant to Internal Revenue Code § 469 (c) (7).

FINDINGS OF FACT

1. Petitioner filed a New York State resident income tax return, form IT-201, for the year 2008, and on it, claimed a refund of $8,490.00. The supplemental income and loss statement included with his 2008 return, federal Schedule E, indicates that petitioner owned rental real estate property located at 618 Bergen Street, Brooklyn, New York (Brooklyn property), and 14 Roosevelt Ave, Middletown, New York (Middletown property).

2. Petitioner's federal Schedule E and New York State resident income tax return indicate total rental losses of $87,822.00. For the Brooklyn property, petitioner reported rents received of $64,650.00 and total expenses of $107,378.00, resulting in a net loss of $42,728.00. For the Middletown property, petitioner reported rents in the amount of $18,000.00 and total expenses of $63,094.00, resulting in a net loss of $45,094.00.

3. On his return, petitioner reported a federal adjusted gross income of $9,959.00, which was calculated after application of the $87,822.00 in total rental losses referred to in Finding of Fact 2.

4. In 2008, petitioner resided at condo that he owned located at 3816 Waldo Avenue, #5A, Bronx, New York. Petitioner was married in 2008, and he was actively trying to rent this condo for many months during 2008, in order to move in with his wife.

5. During 2008, petitioner worked full time as a postal inspector, approximately 39 hours a week, which was lower than average for petitioner, who often worked in excess of 50 hours per week, since his position required him to be available after regular business hours.

6. Petitioner was usually working on his properties when he was not working his regular job, including most major holidays. He was involved hands-on as to nearly all repairs and maintenance, as well as handling all management functions, for the rental properties.

7. Petitioner has been involved in real estate ownership and rental every year since 2003. Tax year 2008 was the first tax year that petitioner elected to be treated as a real estate professional and elected to treat all his interests in rental real estate business activities as a single activity. Petitioner included the required statement making both elections when he filed his personal income tax returns for 2008.

8. The Division of Taxation (Division) issued correspondence to petitioner dated November 1, 2011, indicating that his 2008 income tax return had been selected for review, and specifically addressed the rental real estate loss reported on federal Schedule E. The correspondence requested that petitioner provide the following information: 1) An explanation of his occupation unrelated to the rental property and the hours worked in that position; 2) the exact address of the properties on Schedule E; 3) the number of units in each property; 4) the date each unit in each property was actively rented; 5) the name of the property manager for each property, if applicable; 6) for each rental activity, a list of services performed and hours attributable thereto, appointment books and calendars to support hours claimed and any other records to support the hours attributable to the rental activity; 7) a copy of Form 8582, Passive Activity Loss Limitations, if filed with the IRS; and 8) answers to questions concerning where petitioner's spouse was living during 2008.

9. Despite the fact that petitioner's home had suffered extensive flood and wind damage from Hurricane Irene and tropical storm Lee in August and September 2011, respectively, from which he was attempting to recover, petitioner promptly responded in correspondence dated November 26, 2011, addressing each of the questions listed in Finding of Fact 8, attaching approximately 100 pages of supporting documentation. The documentation included a contemporaneously prepared vehicle log containing 559 entries for tax year 2008, with an

explanation of the purpose of the rental-related task, detailed notes explaining the tasks performed, the travel locations, the miles traveled, the hours expended by petitioner performing the tasks and the number of hours contributed by petitioner's wife for a select portion of the tasks. In addition, petitioner provided his contemporaneously prepared electronic calendar and appointment book from Microsoft Outlook for 2008, with entries on 286 days, a large portion of which showed a direct correlation to the vehicle log entries, and many other entries that supported an estimated additional 10 to 20 hours per month to tend to all the necessary administrative tasks, including internet research, which instructed petitioner how to do his own major repairs. Further, petitioner submitted a final version of flood wall diagrams prepared by him, and his wife's rent bill to substantiate the location of her residence in 2008.

In the explanation of his personal service time, petitioner explained his direct management of the real estate properties that he owns, and listed the "hats" he wears in his real estate trades and businesses. He characterized himself as a file clerk, real estate broker, web site developer, bookkeeper, security guard, accountant, plumber, electrician, carpenter, superintendent, porter, foreman, general contractor, computer technician, architect, engineer and landscaper. He referred to himself as a "big do-it-yourselfer" and had been unfortunate to hire unreliable and unprofessional help for prior projects.

10. Petitioner created the contemporaneous vehicle log during 2008 as a means to track business use of a vehicle. In the log, petitioner also tracked hours associated with use of the vehicle and rental-related tasks, but petitioner's original intention was to create the log primarily to track the mileage associated with business use of the vehicle. As to the hours of personal service performed by petitioner in rental-related activities as portrayed by the vehicle log, petitioner concluded that he spent, at a minimum, 1,872.5 hours.

11. Petitioner's electronic calendar and testimony established that there were rental-related tasks that did not include the use of the vehicle, and therefore, were not included in the 1,872.5 hours recorded by him on the vehicle log. Petitioner was initially under the misunderstanding that those hours, which ranged from 10 to 20 hours per month, as substantiated by the records and testimony, were lost because he would have to estimate some of the time spent on activities associated with and set forth by his calendar entries. In addition, petitioner indicated that there were frequent phone calls or emails to which he responded related to his rental activities that were unplanned and spontaneous, and not listed on his electronic calendar nor require a trip, and thus, were not on the vehicle log.

12. Petitioner also spent personal service time on real estate projects that were other than his two rental properties located in Brooklyn and Middletown, under the business entity known as CLC Property Management (CLC). For CLC, petitioner maintained separate books and logs, business bank and credit card accounts with Citibank, an exclusive business use vehicle, file servers, guide books, tools, and web sites for the business. He maintained on-site home and off-site offices for storage of tools, supplies, files and computer equipment that were used exclusively for this business activity.

13. Petitioner's principal site of his rental business was his home office at the Waldo Avenue, Bronx, New York, address during 2008. It was there that petitioner did research on projects he would personally take part in, correspond with tenants, create and update website information concerning properties, and many other tasks that he characterized as office management. Petitioner's mileage and time spent for trips between his home office and the Brooklyn or Middletown properties were not treated as commuting by petitioner, but rather as business mileage and as hours that contributed to his real estate business personal services. It

was from two storage units located at the Waldo condo that he would transport tools, materials and supplies to work on his rental properties. Petitioner maintained a second vehicle that he used nearly exclusively for the maintenance of his properties.

14. During the hearing, petitioner explicitly "stood by his calculation" of the personal service hours of "a minimum of 1872" as set forth on his vehicle log and by his testimony, and he knew there were personal service hours that were not included in that total, though petitioner seemed unsure as to whether other documents submitted by him (i.e., his Outlook calendar) could increase the time spent on his rental properties.

15. The Division thereafter issued a Statement of Proposed Audit Changes (Statement) dated January 20, 2012, concerning assessment no. L-037184640-2, with the following explanation, in pertinent part:

> "Your 2008 New York State income tax return has been selected for review. In our letter dated 11/01/11, we requested information and documentation to substantiate the rental real estate loss claimed on federal Schedule E, Supplement [sic] Income and Loss.
>
> Thank you for your reply.
>
> As our inquiry letter stated, all rental real estate activities are by default, passive activities. Therefore, losses from rental activities are subject to the passive activity loss (PAL) rules. The PAL rules state that losses from passive activities are not permitted to offset nonpassive income. There are two exceptions to the PAL rules that would allow rental real estate losses to offset nonpassive income.
>
> A. If you are a real estate professional AND you materially participated in each rental activity, you are allowed the rental losses in full.
>
> B. If you actively participated in a passive rental real estate activity and your filing status is married filing separate, you may be able to deduct up to $12,500 of your rental real estate losses from other income reported on your return.
>
> 1. If you lived with your spouse at any time during the year and are filing a separate return, you cannot use the special allowance.

2. If you lived apart from your spouse for the entire tax year and your modified adjusted gross income is less than $50,000, the full $12,500 special allowance can be claimed. However, for every $2 your modified adjusted gross income exceeds $50,000, the allowance is reduced by $1. If your modified adjusted gross income is $75,000 or more, there is no special allowance.

Please note, to qualify as a real estate professional you must meet all three of the following tests.

1. More than half of your personal services must be in real property businesses.

2. You must work more than 750 hours annually in real property businesses.

3. You must materially participate in EACH separate rental real estate activity unless a written election was filed with the ORIGINAL RETURN to treat all real estate rentals as one single activity.

In your reply you stated that you spent 2,047 hours as a US Postal Inspector and you spent 1,872 hours on your rental properties. To qualify as a real estate professional, you must work more time in a real property business than in any other activity. Therefore, you must work more that 2,047 hours in a real property business to qualify as a real estate professional. Since you did not work more than 2,047 hours in a real property business, you do not qualify as a real estate professional.

Additionally, some of the hours you spent working on your rental properties do not count towards qualifying you as a real estate professional or towards material participation. Please note the following hours do not count.

-hours before the taxpayer actually owned the property,
-hours searching for new properties,
-reading reports, preparing budgets, phone calls or visits to monitor operations, preparing tax returns, organizing records and other investor-type time unless the taxpayer is directly involved day-to-day,
-work not customarily done by an owner,
-travel time,
-work which may have been performed by a contractor, employee, or anyone other than the taxpayer,
-time on property held for investment,
-construction time on a rental activity,
-renovation hours on a rental if the property is not leased at the time,
-exaggerated time, and
-no hours count unless the taxpayer owns 5% or more of the activity.

Your MAGI is computed as follows:

Federal Adjusted Gross Income	$ 9,959
Plus: rental real estate losses	87,822
Modified Adjusted Gross Income	$ 97,781

Since you do not qualify as a real estate professional and your MAGI is greater than $75,000, your rental losses are limited to the amount of passive income reported on your return."

Based on the foregoing explanation, a recomputation of petitioner's return resulted in additional tax due in the amount of $6,248.00, plus interest.

16. Immediately upon receipt of the Division's Statement, on January 27, 2012, petitioner called and spoke with the auditor who made the findings in the Statement dated January 20, 2012, noted his disagreement and asked to discuss the matter further. Petitioner informed the auditor that she had not considered time also spent apart from his rental properties on other real estate business activities. Petitioner was told that although the auditor's original letter only mentioned petitioner's rental properties, the audit would be inclusive of those other activities as well.

17. Petitioner then provided a detailed written response dated February 16, 2012, of approximately 225 pages, contesting the assessment finding and providing additional documents and exhibits. In his letter petitioner provided some background on the rental properties as to the expenses and needed repairs during 2008, in pertinent part, as follows:

"Our building in Brooklyn was built in 1910 and is old. Things break often, leak often, and our tenants require a lot of upkeep. Our house upstate, is a 'money pit' in the true sense of the word, built in 1949 it is old and requires a lot of upkeep, but ironically that is the least of my concerns.

The house upstate, 14 Roosevelt Ave. was supposed to be my dream home. But shortly after purchasing it, it became my nightmare. The house upstate sustains devastating floods yearly, sometimes twice a year. Over the time that we have owned it we have spent several thousands of dollars hiring professional contractors to do everything from concrete work, landscaping, drainage, roofing, walls, plumbing, etc. to stop my property from flooding. I had

> taken out second mortgages, maxed out credit cards, everything. All the money I spent on professional help, have all failed miserably. We have paid top dollar for work that was sub par or completely ineffective. Only leaving us with severe credit card debt, and paid for 'solutions' that never worked. My only option, invest in my own 'sweat equity,' do more on my own. My time was the only thing that I could do that was essentially 'free.' Plus the amount of research and effort I put in before and after a project was more than any other professional help has done."

18. In his correspondence dated February 16, 2012, petitioner also responded to the various categories of hours challenged by the Division in its Statement of Proposed Audit Changes, as follows:

(1) Hours before the taxpayer actually owned the property and hours searching for new properties. Petitioner's vehicle log did not include hours in these categories.

(2) Reading reports, preparing budgets, phone calls or visits to monitor operations, preparing tax returns, organizing records and other investor-type time unless the taxpayer is directly involved day-to-day. Petitioner was directly involved with his properties at all times, in far more ways than any investor and many landlords. He handled all aspects of rental management, accounting, repairs, budgeting, tenant relations and much more. The evidence petitioner submitted at the hearing included letters from tenants that also supported his hands-on approach to his rental management.

(3) Work not customarily done by an owner. Petitioner has been a homeowner since the age of 22 and involved in the rental business since about age 24. He was raised in a family with handy parents and was exposed to helping them with projects at an early age. The work undertaken by petitioner was the type of work undertaken by any owner who was young, with limited resources, able-bodied, knowledgeable and willing to put forth an unlimited amount of sweat equity. He gained experience from early years, and carried it forward, building on that

body of knowledge. He accessed internet resources, television shows and other forums that assisted him in his "do-it-yourself" endeavors. There was little that was not customarily done by this property owner.

In the *Passive Activity Loss Audit Technique Guide*, published by the Internal Revenue Service (December 2004), work not ordinarily done by an owner is described as work performed by an owner that would normally be assigned to an employee, in an attempt to avoid the passive loss limitations. In a case such as this one, where the property is owned by petitioner, there are no employees to whom work could be passed on. In either case, petitioner does not have any hours in his log that fall into this excluded title.

(4) Travel time. This was a more controversial category, and petitioner received many questions about the nature of his travel and the hours he counted. Petitioner's travel was in the nature of loading and transporting tools and equipment from storage units at his condo to the properties, travel to secure supplies and materials used in repairs, transportation to maintain the vehicle he used almost exclusively for his properties, travel to the properties to work on a repair, handle a management issue, show a unit to a new tenant and other such tasks. The activities were regular, continuous and substantial, and integral to the management and maintenance of the rental properties. Petitioner did not consider this travel to meet any of the traditional attributes of "commuting" and as such, did not treat the travel in this fashion.

(5) Work which may have been performed by a contractor, employee, or anyone other than the taxpayer. Petitioner did not count time for jobs performed by others, and there are numerous entries in petitioner's log showing a clear separation of hours for particular tasks done by his wife or others, such as his father, when they helped him.

(6) Time on property held for investment. This category does not apply to petitioner, since he materially participated in the direct management of the rental properties. The properties were not a mere investment held for the return of capital.

(7) Construction time on a rental activity. Petitioner's testimony and explanation of the photos submitted into evidence suggest that petitioner's work involved some major and minor repairs, a variety of maintenance tasks and infrastructure repairs. Petitioner did not undertake construction of the rental property.

(8) Renovation hours on a rental if the property is not leased at the time. This does not apply to petitioner's properties, as none of the properties were vacant in 2008, and all repair work was done while the properties were occupied.

(9) Exaggerated time. This does not apply to petitioner and he suggests the support of his logs, receipts, bank and credit card statements, EZ pass records, telephone bills, etc., to verify and support the time he actually spent to manage, maintain and repair his properties.

(10) No hours count unless the taxpayer owns 5% or more of the activity. Since petitioner was the owner of his rentals, this de minimis ownership category does not apply in this case.

19. Additionally addressed by petitioner's February 16, 2012 correspondence, and further explained by his testimony at the hearing, he described several hundred hours of personal service that are not directly connected to his Brooklyn and Middletown rental properties, and therefore, not on his vehicle log, but instead, are a part of his real estate consulting that involved similar issues, some common ownership, geographic proximity to his own rentals, his direct participation and similar expenses. Petitioner's election under IRC § 469 (c) (7) to treat all interests in rental real estate as a single rental real estate activity, included these projects. These

activities, hours and expenses were kept on what petitioner referred to as his "broker billable log," a separate contemporaneously prepared log, and was divided into the following three primary projects:

(1) In 2008, petitioner co-owned a property with his sister, Betsy Chery, located at 176 Newman Street, Metuchen, New Jersey. During 2008, Ms. Chery found a bank-owned home in foreclosure that she wanted to purchase, and sought assistance from petitioner to evaluate the sale and rental of the Metuchen property, in addition to an assessment of the investment of the bank-owned property. Petitioner created a website for her property, researched area rentals and sales, visited homes that were for rent and sale, screened applicants, conducted open houses and provided general real estate advice. Petitioner's contemporaneously prepared broker billable log shows entries for 380 miles traveled to the property between July 3, 2008 and September 16, 2008, expenses of $75.00 and 99 hours of personal service performed by petitioner. Petitioner was paid $1,000.00 for his efforts by Ms. Chery, and she confirmed the services performed in a letter that was submitted as part of the record. Petitioner did not include this amount in income or record the expenses associated with this and any of the other real estate activities on his personal income tax return for 2008, since the ventures "were not successful" according to petitioner, and he did not believe it was necessary to do so.

(2) During 2008, petitioner also assisted a colleague, Victor Evans, with a website creation for his property located at 531 Coventry Dr., Nutley, New Jersey. Mr. Evans was attempting to sell the property, but in the interim was also offering it for rent. Petitioner did a comparative analysis for Mr. Evans to determine rental rates, showed Mr. Evans similar rentals and sales in the same complex and vicinity, performed research for Mr. Evans to determine a sales price, conducted open houses, screened applicants, and gave a tour to several potential

customers and renters of the property. For these services, which took place from February 2008 through May 2008, petitioner and Mr. Evans had an agreement for payment based upon a rental or sale result. However, after some period of time, Mr. Evans decided he needed someone to handle these matters who had more time to devote to them, and petitioner did not receive any payment for the services he rendered. Petitioner's broker billable log, contemporaneously created, indicated petitioner had traveled 416 miles, incurred $90.00 in expenses, and spent 102 hours assisting Mr. Evans in these real estate endeavors. Mr. Evans confirmed the tasks done by petitioner and their business arrangement in a letter signed by him, which was submitted as part of the record.

(3) Petitioner put forth additional personal service time into the rental of 3816 Waldo Ave, Bronx, New York, a condo he owned and lived in during 2008, when he was looking to move in with his new wife. Between January and December 2008, petitioner created a website, performed market research, advertised it, held open houses, and responded to applicant inquiries, all in an effort to rent the condo. Recorded in his contemporaneously prepared broker billable log was 88 hours of personal service time toward this endeavor.

20. Correspondence from two previous tenants was submitted into evidence. One had resided at the Middletown property during 2008, and the other resided at the Brooklyn location during 2008. They both confirmed petitioner's hands-on approach to the repairs and maintenance with little exception, and the fact that a management company did not tend to these items in petitioner's place. One stated that only on occasion did petitioner hire a specialized repair person to tend to a job.

21. The Division issued to petitioner a Notice of Deficiency dated April 4, 2012, asserting additional personal income tax due in the amount of $6,248.00, plus interest, for tax

year 2008, referring to its explanation and computation set forth in the Statement (see finding of fact 15).

22. The Division further issued correspondence dated April 30, 2012, noting four dates with alleged inconsistencies between what petitioner had listed on his calendar and what he listed on his vehicle log. In two of the four cases, there was no entry on the calendar, but petitioner had listed tasks he completed on his vehicle log. In the other two cases, the calendar had an entry for answering general and tenant screening emails, and there was also a vehicle log entry for other jobs done on the same days (property inspection, maintenance, repairs and acquiring supplies). These were deemed inconsistencies that did not allow the auditor to determine the actual number of hours that were spent working on the rental properties.

In the alternative, the auditor suggested that if she considered the vehicle log alone, the hours would only total 1,663, since she had disallowed "hours spent on vehicle maintenance, gasoline, meeting with contractors, meter readings, research, and the hours listed under other. . . ."

23. Petitioner again submitted a timely response dated May 10, 2012, disagreeing with the auditor's conclusions. Petitioner explained that the auditor would not have found certain days on his calendar matching up with his vehicle log, if in fact, tasks such as tenant screening emails and other office functions are performed in his home office and would not require use of his vehicle. In addition, there was sometimes the need for an unscheduled trip to take care of something at his properties that would not be on his calendar because they were simply unscheduled. Petitioner requested additional information concerning the disallowance of hours, and the reasoning for the same. He also disputed his failure to receive credit for the hours he spent on other real estate endeavors that he chose to include as related to, but separate from, his

rental properties. Petitioner was under the belief that he was not required to separately report the real estate consulting activities on his tax return since the attempts toward rental and sale were largely unsuccessful. He further indicated a willingness to make such correction if the same should have been a part of the income tax returns he filed.

24. The Division responded in a Response to Taxpayer Inquiry dated June 12, 2012, sustaining its assessment. The letter identified hours in the mileage log that were disallowed as including vehicle maintenance, insurance meetings, fueling the vehicle, dining, banking, meeting with contractors, equipment pickup and drop off, and meter readings. As to the additional real estate activities apart from petitioner's rentals, the auditor, without explanation, deemed the hours to be a hobby, not a business, and disallowed them. This was the first time the auditor had characterized such activities as a hobby. Petitioner was advised that since the Notice of Deficiency was mailed to him on April 4, 2012, he had 90 days from that time within which to either file a request for conciliation conference with the Bureau of Conciliation and Mediation Services (BCMS) or a petition with the Division of Tax Appeals.

25. A conciliation conference was held by BCMS on January 8, 2013, and the statutory notice was sustained by the Conciliation Order dated March 15, 2013 (CMS No. 253310). A petition was thereafter filed June 3, 2013, protesting the disallowance of his real estate professional status, certain hours spent on his rental properties, his wife's hours, other real estate activity hours, and for the Division's failure to process his 2008 amended personal income tax return and its failure to consider the net operating loss carry backs from casualty losses suffered from Hurricane Irene, Tropical Storm Lee (2011), and other flooding sustained by petitioner's properties.

26. Petitioner amended his 2008 personal income tax return to carry back casualty and net operating losses from 2010, and submitted it to the Division on or about April 2013. By correspondence dated November 1, 2013, the Division rejected the amended tax return as filed with the following explanation, in pertinent part:

> "You formally protested the above assessment [L-037184640-2] and after a conciliation conference was held, the conferee, Lorraine Stein, sustained the assessment. Therefore, the rental loss claimed on line 11 of Form IT-201-X, Amended Resident Income Tax Return, cannot be allowed. Additionally, you claimed other losses of $33,279 on line 8 of Form IT-201-X and a net operating loss of $47,538 on line 15 of Form IT-201-X. However, you did not supply any documentation to verify those losses.
>
> As a result the assessment is sustained."

27. Petitioner submitted into evidence Internal Revenue Service rulings and referenced case law in support of his position that the deductions generated by the carry backs on petitioner's tax return are allowable.

SUMMARY OF THE PARTIES' POSITIONS

28. Petitioner maintains that for tax year 2008 he was a real estate professional under IRC § 469 (c) (7), having performed more than half of his personal service hours during the year in real property trade or businesses in which he materially participated, and worked more than 750 hours per year in those real estate activities. Petitioner asserts that his real estate personal service hours in total is made up of hours from his rental property vehicle log, his electronic calendar, and his real estate consulting business and the hours reflected in his broker billable log, and exceeds his personal service hours from his non-real estate activities. He further reiterated that the methods, expenses and infrastructure employed in CLC are not those implemented by someone who is merely seeking to engage in a hobby, and the hours he spent in furtherance of this business is properly included in his real property trade or businesses.

29. The Division asserts that petitioner did not meet his burden of proof regarding his expenditure of time in his real estate activities sufficient to show that he spent more than 50% of his personal service time attributed to such activities.

CONCLUSIONS OF LAW

A. In this case, the parties dispute whether petitioner is entitled to a refund claim based on passive rental losses incurred in 2008 from his Brooklyn and Middletown, New York rental properties. Section 469 (a) of the Internal Revenue Code (IRC) generally disallows any passive activity loss. A passive activity loss is defined as the excess of the aggregate losses from all passive activities for the taxable year over the aggregate income from all passive activities for that year (***see*** IRC § 469 [d] [1]). A passive activity is any trade or business in which the taxpayer does not materially participate (IRC § 469 [c] [1]). A rental activity is generally treated as a per se passive activity regardless of whether the taxpayer materially participates (IRC § 469 [c] [2], [4]).

B. An exception to the rule that a rental activity is per se passive is found in IRC § 469 (c) (7), which provides that the rental activities of certain taxpayers in real property trades or businesses, i.e. "real estate professionals," are not per se passive activities under section 469 (c) (2), but are treated as a trade or business subject to the material participation requirements of section 469(c) (1) (***see*** Treas Reg § 1.469 [e] [1]). A taxpayer may qualify as a real estate professional if (1) more than one half of the personal services performed in all the trades or businesses by the taxpayer during the taxable year, are performed in real property trades or businesses in which the taxpayer materially participates, and (2) the taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates (IRC § 469 [c] [7] [B] [i], [ii]). A "real property trade or business" means any real property development, redevelopment, construction, reconstruction,

acquisition, conversion, rental, operation, management, leasing or brokerage trade or business (IRC § 469 [c] [7] [C]). A taxpayer materially participates in an activity if he or she works on a regular, continuous and substantial basis in operations (IRC § 469 [h] [1] [A] - [C]). To meet the record-keeping requirements for material participation, a taxpayer must establish his participation by any reasonable means. Reasonable means may include, but are not limited to, an identification of the services provided and the approximate number of hours spent performing such services, based upon appointment books, calendars or narrative summaries. Contemporaneous daily records are not required if the taxpayer's participation can be reasonably established, i.e., there is no credibility issue (Treas Reg § 469-5T [f] [4]). In the case of a joint tax return, either spouse may satisfy both requirements for a real estate professional, but the requirements are satisfied only if either one separately satisfies such requirements (IRC § 469 [c] [7] [B] [ii]).

C. The central issue in this matter is whether petitioner has established that he spent more than one-half of his personal services during the year in real property trades or businesses in which petitioner materially participated. Petitioner's material participation is not disputed, since petitioner meets several of the seven tests provided in Treasury Regulation § 1.469-5T (a), when only one is required to be met. The parties also do not dispute that petitioner maintained a full-time position as a U.S. Postal Inspector during 2008, and worked 2,047 hours in that position. The parties also agree that for petitioner to qualify as a real estate professional under IRC § 469 (c) (7), petitioner would have had to spend in excess of 2,047 hours for petitioner to meet the requirement that more than one-half of his personal services for the year was devoted to real estate endeavors. What the parties have not agreed upon is what activities and hours do or do not contribute to petitioner's personal service hours above and beyond those recorded on his vehicle

log in the amount of 1,872, as clearly documented by petitioner, or 1,663 hours as the reduced amount accepted by the auditor.

D. First, concerning the Division's reduction of the personal service hours to 1,663 (***see*** Finding of Fact 21), it is noted that the hours listed under "other" in petitioner's vehicle log were not a part of his total personal service hours and, therefore, this category cannot account for any of the Divison's disallowed hours. Since the Division stated that it did, in fact, include the hours in this column in its total of disallowed hours, the Division's total hours would be 1,725 rather than 1,663, accounting for the erroneous inclusion of those 62 hours.

E. The Division's Statement of Proposed Audit Changes lists categories of hours that the Division disallowed (***see*** Finding of Fact 18) as not counted in the total number of personal service hours qualifying petitioner as a real estate professional, or toward his material participation. However, the Division did not separate the categories by assigning a specific number of disallowed hours to each of them, in order that petitioner could more accurately address the hours in each category. In any event, petitioner addressed each category in his correspondence dated February 16, 2012 (***see*** Finding of Fact 18). The correspondence reasoning was further discussed and explained by petitioner at the hearing, and additional attention was given to the one category that remained the focus of continued dispute: petitioner's travel time for his rental activities. This time included travel from his home office to his rental properties and back, and between rental properties when he would travel from one to another, in addition to the transport of tools for repairs and maintenance, travel to perform management functions such as collecting rent, showing units, and interviewing potential tenants, and many other tasks directly related to the operation of the rental properties. The auditor's list of activities for non-qualifying time was, in large measure, the same as those delineated in the *Passive Activity Loss*

Audit Technique Guide, published by the Internal Revenue Service (December 2004). In that guide, the IRS states its opinion with regard to travel time:

> "Travel time generally should not be considered in computing the hourly tests for material participation, particularly if other factors indicate the taxpayer is not participating in the activity on a regular, continuous and substantial basis. Legislative history provides that 'services must be integral to operations.' It is somewhat difficult to construe that travel constitutes 'services' or 'participation' as contemplated by Congress or the Regulations. More importantly, travel is not *integral* to operations in most cases."

A footnote to the IRS opinion above referencing travel is as follows: "We have no express statutory guidance on travel. While not precedent setting[1] and just a summary opinion, the following case provides guidance on travel time: ***Thomas E. Truskowsky***, T.C. Summary Opinion 2003-130." For the suggested purpose of guidance, ***Truskowsky*** is reviewed below.

Truskowsky involved married taxpayers who were not entitled to deduct Schedule C losses claimed in connection with their passive cattle breeding activities, when they failed to meet a 500 work-hour requirement after certain work and commuting hours were disallowed. Their level of participation in the cattle breeding did not exceed that of a third party hired to care for the animals, the taxpayers failed to establish that they participated in the activities on a regular, continuous and substantial basis, and the court was unable to find from a preponderance of the evidence that the taxpayers were involved in the day-to-day management or operations of the cattle activity. Further, the taxpayers in ***Truskowsky*** failed to keep any log of the actual number of hours they devoted to the cattle activity. Even despite such shortcomings, the Tax Court recognized that travel in some circumstances can be work done in connection with a trade or business, and agreed in ***Truskowsky*** that the taxpayers' travel between the location of the

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[1] The case opinion states as follows: "PURSUANT TO INTERNAL REVENUE CODE SECTION 7463(b), THIS OPINION MAY NOT BE TREATED AS PRECEDENT FOR ANY OTHER CASE."

cattle farm and two facilities that rendered veterinary breeding services was "work done in connection with their cattle activity." The facts of the case at hand could not be more different from ***Truskowsky***, and if anything, such differences lend support for petitioner to properly deduct his travel costs and time. The guidance provided by ***Truskowsky*** is such a contrast to this case that it shows that petitioner's travel to his rental properties is exceedingly more involved than the taxpayers who traveled to merely join their cattle at facilities handling in vitro fertilizations and embryo transfers, after the cattle was transported by a livestock hauler contracted by the taxpayers. Unlike ***Truskowsky***, petitioner's travel was unequivocally an integral part of the rental property operations. Petitioner participated in his rental activities on a regular, continuous and substantial basis, hired no third party who spent anywhere near the time that petitioner spent, and was clearly involved in the day-to-day management of his rental property in every aspect. Petitioner maintained a meticulous contemporaneous vehicle log and had more than sufficient supplemental documentation of his hours of participation. Petitioner's travel also frequently involved the transport of tools and materials to do the repairs himself. If the court found that the ***Truskowsky*** taxpayers' travel to join their animals at the veterinary breeding was "work done in connection with their cattle activity," then clearly, petitioner's travel herein, as an integral part of maintaining, repairing and managing his properties was not commuting, was also work done in connection with his rental activity, and the hours should be counted.

In another U.S. Tax Court decision, ***Trezeciak v. Commr. of Internal Revenue*** (103 TCM 1448 [2012]), a case which was ultimately about the recovery of court costs, an IRS appeals office conceded that traveling hours from a home office to various rental properties should count toward the hours evaluated in the real estate professional test under section 469 (c) (7) (B) (ii), because these are not nondeductible commuting hours.

Petitioner went to great lengths to document and explain prior to the hearing each category that was challenged by the Division, and credibly explained during the hearing, how and why the travel category of personal service time was integrally related to the rental properties, and specifically related to his care, management, repairs and general operation of such properties. He provided more than sufficient explanation to meet his burden of proving that the Division's disallowance of certain vehicle log hours should be disregarded. Accordingly, petitioner's personal service time toward his real estate activities, as documented by his vehicle log is accepted in its entirety as 1,872 hours, and the Division's disallowance of hours is rejected.

F. Petitioner is a well-educated, hard working young man, with a BA in criminal justice and a masters in public administration. He developed an interest in real estate in his early 20's. During the year in question, petitioner was 29 years old, and approached the management and operation of his rental properties from a posture of sophistication and dedication that far exceeded his years. His records reflected a high level of conscientiousness. Concerning his personal service hours, petitioner cited to a U.S. Tax Court case (***Mowafi v. Commr. of Internal Revenue***, TC Memo 2001-111 [2001]) in support of the principle that petitioner's burden requires, in cases of this type, that he maintain sufficient documentation to substantiate the time that he devoted to his rental properties, and he quoted the Court as stating the following:

> "As to the evidence that he may introduce to prove the amount of his personal time that he devoted to the rental properties, section 1.469-5T (f) (4), Temporary Income Tax Regs., 53 Fed. Reg. 5727 [Feb. 25, 1988], provides:
>
> (4) Methods of proof. The extent of an individual's participation in an activity may be established by any reasonable means. Contemporaneous daily time reports, logs, or similar documents are not required if the extent of such participation may be established by other reasonable means. Reasonable means for purposes of this paragraph may include but are not limited to the identification of services performed over a period of time and the approximate number of hours

> spent performing such services during such period, based on appointment books, calendars, or narrative summaries."

In ***Mowafi***, the U.S. Tax Court held that petitioner failed to carry his burden of proving that he was a real estate professional pursuant to IRC § 469 (c) (7) (B). The taxpayer in ***Mowafi*** relied primarily upon testimony at trial and noncontemporaneous logs that he prepared in connection with his tax audit. The court found the logs to be untrustworthy, and declined to rely upon them. Further, the court found petitioner's testimony in ***Mowafi*** to be improbable, questionable, uncorroborated, inconsistent and self-serving. This is an extreme contrast from petitioner herein. Mr. Chery submitted a contemporaneous vehicle log showing miles traveled and hours devoted to his rental properties, and his Outlook electronic calendar entries for 2008. In addition, he submitted his broker billable log, a contemporaneous compilation of miles driven, expenses and hours spent on several other real estate projects to which he consulted. His testimony explained his entries and his method of preparing the logs sufficiently to find them trustworthy depictions of his efforts. His calendar entries corroborated his vehicle log entries in large measure. In addition, there were many tasks outlined in his calendar that did not require a trip, and thus, he neither added this time to his vehicle log, nor did he separately list such time as personal service hours. Petitioner's attitude toward his record keeping and recording of hours and activities was one of preciseness, and I found his methods trustworthy and reliable. Though permissible, petitioner avoided the use of estimates, even where he could do so based upon his own documentation, calendar entries and actual responsibilities. Having thoroughly reviewed petitioner's Outlook calendar entries and having carefully evaluated the undeniably credible testimony of petitioner, there are clearly additional personal service hours spent on petitioner's rental properties that fall into a myriad of tasks handled by petitioner as a property manager and

owner. Though not an exhaustive list, these included the screening of tenant qualifications, responding to tenant emails, research on property sewer codes and regulations, cable company contacts, dealing with insurance claim issues, calls and letters, research on repair projects, walk-through appointments with tenants who were departing a rental unit, background checks on potential tenants, verifying and issuing security deposit refunds, preparation of rental leases, creation of advertisements, update of web information, and making appointments for various services for the rental units. Based upon the contemporaneously prepared electronic calendar, the list included many tasks not listed in petitioner's vehicle log, and therefore, is not a duplication of personal service hours tallied on the vehicle log. A thorough review of this information revealed that petitioner devoted hours conservatively estimated at 15 hours per month, a mere half hour each day on average, which were unaccounted for in petitioner's personal service time. These 180 hours should have been added to the vehicle log hours of 1,872, in determining petitioner's status as a real estate professional.

G. Although the personal service hours set forth above, totaling 2,052 hours, would be sufficient to finalize a determination of petitioner's real estate professional status, petitioner also chose to group 289 hours from his real estate consulting business, CLC, with his rental activities. Before addressing the grouping of the activity, it is necessary to clarify the nature of petitioner's activities at CLC. Petitioner credibly testified as to how he treated CLC as a business given the projects he undertook, and he provided information that lent credence to his business intent (***see*** Finding of Fact 12). Although petitioner mistakenly omitted setting forth his CLC activities on a federal Schedule C for 2008, having referred to the projects as "unsuccessful ventures," there is no evidence that petitioner was conducting such activities as a hobby, and this characterization by the Division is rejected. However, for proper reporting, petitioner should have included the

$1,000.00 he received from Betsy Chery in income on federal Schedule C, for the personal services he provided, and taken the corresponding deductions for his out of pocket expenses and costs of travel, for the services he provided her and Victor Evans (***see*** Finding of Fact 19). Petitioner has indicated a clear willingness to correct this error for 2008, and these income and expenses should be accounted for accordingly. If it is further determined that petitioner should be granted the status of real estate professional and his rental losses allowed without limitation, the addition of this income would not, in any event, produce additional tax due for 2008.

H. Concerning the personal service hours consumed by the three real estate activities (***see*** Finding of Fact 19), in which petitioner materially participated, Treas Reg § 1.469-4 sets forth the rules for grouping a taxpayer's trade or business activities and rental activities for purposes of applying the passive activity loss and credit limitation rules of IRC § 469. It defines trade or business activities in pertinent part as activities other than rental activities that involve the conduct of a trade or business within the meaning of IRC § 162, which would include petitioner's real estate consulting endeavors. One or more trade or business activities or rental activities may be treated as a single activity if the activities constitute an appropriate economic unit (Treas Reg 1.469-4 [c] [1]), and is subject to a facts and circumstances test as follows:

> "A taxpayer may use any reasonable method of applying the relevant facts and circumstances in grouping activities. The factors listed below, not all of which are necessary for a taxpayer to treat more than one activity as a single activity, are given the greatest weight in determining whether activities constitute an appropriate economic unit for the measurement of gain or loss for purposes of section 469 –
>
> (i) Similarities and differences in types of trades or businesses;
> (ii) The extent of common control;
> (iii) The extent of common ownership;
> (iv) Geographic location; and
> (v) Interdependencies between or among the activities . . . .
>
> * * *

(d) Limitation on grouping certain activities.–The grouping of activities under this section is subject to the following limitations:

(1) Grouping rental activities with other trade or business activities

(i) Rule.–A rental activity may not be grouped with a trade or business activity unless the activities being grouped together constitute an appropriate economic unit under paragraph (c) of this section and –

* * *

(B) The trade or business activity is insubstantial in relation to the rental activity. . .” (Treas. Reg. § 1.469-4 [c] [2]; [d]).

Given the nature of petitioner’s real estate consulting projects, their direct connection to the real estate market as either rental or sale, the common control by petitioner of his own condo and rentals, the common ownership interest in his sister’s home and his own condo and rentals, the relative proximity of the properties involved, and the clear similarities of the endeavors as they all involved real estate analysis for either sale or rental, tenant evaluations and similarly connected income and expense considerations, the rental activities and petitioner’s CLC activities constitute an appropriate economic unit (Treas Reg 1.469-4 [c] [2]). Lastly, in this case, since the CLC activities are insubstantial in relation to petitioner’s rentals, the grouping of the activities as a single activity is not prohibited (Treas Reg 1.469-4 [d] [1] [i] [B]). Accordingly, the 289 hours of personal service represented by the CLC activities are properly grouped with the previously identified hours of personal service that petitioner performed in real property trades or businesses. When the 180 and 289 hours of personal service discussed above are added to the 1,872 documented and accepted as accurate from petitioner’s vehicle log, the result is that more than one-half of petitioner’s total personal service hours are performed in real property trades or businesses in which petitioner materially participates (IRC § 469 [c[[7] [B] [i]). Since petitioner materially participates in all of his activities, and far exceeds the 750-hour

requirement of IRC § 469 (c) (7) (B) (ii), petitioner meets all the requirements to be characterized as a real estate professional for 2008 pursuant to IRC § 469 (c) (7) (B).[2] Accordingly, petitioner's federal Schedule E rental losses should be allowed without limitation.

I. The petition of Claudel Chery is hereby granted and the Notice of Deficiency dated April 12, 2012, is canceled.

DATED: Albany, New York
December 3, 2015

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE

[2] Petitioner filed a 2008 amended income tax return on or about April 2013, which addressed extraordinary flood casualty losses from 2008 and 2011, in addition to a net operating loss carry-back from 2011. At the hearing on August 14, 2014, the Division's representative reasoned that the non-processing of the amended tax return was due to the fact that petitioner's real estate professional status had not yet been determined. Petitioner's motion to compel the Division to take action was not within the jurisdiction of the Division of Tax Appeals. However, upon a final determination concerning petitioner's real estate professional status for tax year 2008, the amended return for 2008 shall be promptly processed and all tax issues concerning this tax year resolved.