

Introduction

There are certain unique intricacies in applying the Passive Activity Loss (PAL) rules of the Internal Revenue Code (IRC) under § 469 to trusts and estates. The Lawrence Trust, which has a sole asset in the shape of a loss-producing real estate company, needs a close examination to ascertain whether its losses can be offset against other revenues. The main question is whether the material participation of the trust, one of the main requirements to avoid PAL limitations, is to be assessed solely by the trustee's actions, Richard Lawrence, or whether it is possible to combine the efforts of the trust's employees. In this analysis, it can be concluded that, in the case of a trust, the actions of all agents and employees of the trust, as well as the trustee, should be taken into account, and, upon such aggregation, the Lawrence Trust passes the material participation standard.

The PAL Rules and the Material Participation Standard

The IRC § 469 rules on PAL were created to prevent taxpayers from using losses from passive investments to offset income from salaries, portfolios, or active businesses. An activity that is usually considered passive is any trade or business in which the taxpayer does not play a material role. As per IRC § 469(h) (1), to have material participation, a person must engage in the activities on a regular, continuous, and substantial basis (Thomson Reuters Checkpoint Edge, 2025a). In non-corporate taxpayers, the regulations offer various objective tests to meet this requirement, with the most frequent being the 500-hours test (*Treas. Reg. § 1.469-5T(a)*) (Vital Law, 2025a). In accordance with the opinion of Raabe et al., (2024), such rules are fully applicable where the estate and trusts are concerned, and one should have a clear picture of whose actions should be regarded as the activities of the trust itself.

Determining a Trust's Material Participation: Aggregating Fiduciary and Agent Activities

The essential issue is how a trust, being an intangible one, can satisfy the material participation test. The IRS has also issued clear guidance, stating that a trust may engage in a material business activity through the efforts of its fiduciaries or authorized agents. In Rev. Rul. 2004-56, the IRS discussed a situation in which a trust and a corporate trustee owned a business that employed a professional manager to operate it daily (Thomson Reuters Checkpoint Edge, 2025b). The case was decided to rely on the trust's factual involvement, based on the trustee's actions, the trust's employees' activities, and the actions of the trust's agents who possess the capacity to transact business. The time of the trustee and staff members is totaled to determine whether the 500-hour test is met.

The most important thing is to apply this precedent to the Lawrence Trust. The fiduciary of the trust property is Richard Lawrence, who is the trustee. Although he also takes part in operational-level matters, he does not personally satisfy the material participation test. He has, however, employed a full-time operations manager and 75 staffers as trust agents. The efforts of the trustee, employees, and agents are considered when determining whether the trust materially participates (Vital Law, 2025b; Thomson Reuters Checkpoint Edge, 2025c). This is the principle of aggregation on which the analysis of the Lawrence Trust is based.

Analysis of the Lawrence Trust's Circumstances

Depending on the principles of Rev. Rul. 2004-56 and the comments to this ruling, the Lawrence Trust is well placed in claiming that it is materially involved in the real estate business. The trust has a 75-person workforce, including a full-time operations manager. The total number of labor hours that such employees have worked within a year is bound to exceed the material

participation limit of 500 hours, as per *Treas. Reg. § 1.469-5T(a)* (Borkes, 2019). The real estate enterprise is not a passive, hands-off investment of the trust, but an active business or trade operated by a team of workers employed and controlled by a trustee.

This opinion is supported in various commentaries of tax services. A fiduciary entity that owns a business, the involvement of the fiduciary, the employees, and agents of the fiduciary must be combined to conclude whether any significant involvement of the entity takes place (Walter & Wright, 2022, *Federal Tax Coordinator 2d § L-6203*). One more analysis at the same service explains that an estate or trust is materially participating in an activity “if the executor, trustee, etc. (or a beneficiary, in some cases) is materially participating in his or her individual capacity” or through agents (Thomson Reuters Checkpoint Edge, 2025e). Another practical guide in CCH VitalLaw also confirms that, to pass the test, the participation of the fiduciary and that of the employees and other agents working in the trust must be combined. Consequently, the role of Richard, coupled with the vast amount of work done by his employees, implies that the losses incurred by Lawrence Properties cannot be treated as passive activity losses. This would enable the trust to use these losses to offset other sources of income, providing significant tax advantages. It must be well documented, and, according to one of the CCH planning guides, taxpayers are expected to keep detailed time reports, logs, or other records at the time of participation to prove the hours of participation (Vital Law, 2025c).

Ethical and Stewardship Considerations

On biblical and ethical grounds, being a trustee is a highly significant responsibility and a form of stewardship. In addition, the verse from the Bible, 1 Corinthians 4:2, states that “it is required of stewards that they be found faithful” (Bible Gateway, 2025). As a trustee, Richard

Lawrence owes a fiduciary duty of loyalty to the trust's beneficiaries. This responsibility lies in sound tax management. Richard is dutifully carrying out his stewardship by well-organizing the administration of the real estate firm and understanding the regulations of the PAL to take advantage of operating losses in a lawful manner (Walter & Wright, 2022). Responsible management of the estate means ensuring that the trust does not violate the tax code and that the trust's assets achieve maximum utility; that is one of the primary tasks of a trustee.

Conclusion

In short, the PAL rules apply to the Lawrence Trust, but it is probable that the trust qualifies as the material participation exception. Material participation is not determined by the trustee's personal hours, but by the total hours of the trustee and all other persons who work as employees or agents of the trust. The concerted action of the large workforce should enable the trust to evidence the fact that it is in the active trade or business of managing real estate. Thus, Lawrence Properties' operating losses will likely not be passive. To support this standpoint, it is advisable that the firm help Richard record all the hours the trust employees have worked.

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