Due Diligence FAQ

Spousal Real Estate Professional Status

(REPS)

Tax Purpose:

Concur with the firm's existing "Not Recommended" disposition for Spousal REPS as a general strategy for the typical high-W2-income tech-employee client. The legal mechanics are sound and the tax benefit, when properly executed, is real — but the strategy imposes a structural requirement (one spouse's exit from active employment) and an unusually strict, litigation-tested documentation burden that make it poorly suited to most clients in this segment, and the economics do not justify the opportunity cost below roughly $3–4 million of deployable real estate capital.

Mechanics & Key Considerations:

- IRC §469 generally treats losses from "passive activities" — including rental real estate — as deductible only against passive income, not against wages, salary, or other active/portfolio income
- To qualify, a taxpayer must satisfy a two-part test for the taxable year:
  - (1) more than one-half of the personal services the taxpayer performs in all trades or businesses during the year must be performed in real property trades or businesses in which the taxpayer materially participates
  - (2) the taxpayer must perform more than 750 hours of services during the year in those real property trades or businesses
- Because the more-than-half test is measured against the taxpayer's total personal service hours across all trades or businesses, a spouse who works a demanding full-time W-2 job is, as a practical matter, unable to also show that a majority of their hours went into real estate
- The critical mechanical feature that makes this a *spousal* strategy is Treas
- A commonly discussed alternative — the STR loophole (Candidate #2) — does not rely on REPS at all and avoids the core structural cost (the career/income sacrifice), since either spouse can qualify by materially participating in a short-term rental without either spouse being classified as a "real estate professional."

Structure:

Spousal Real Estate Professional Status ("Spousal REPS") is a passive-loss unlocking strategy under which one spouse on a joint return qualifies as a "real estate professional" under IRC §469(c)(7), thereby converting the couple's rental real estate losses from passive to non-passive and permitting those losses — principally accelerated depreciation generated through cost segregation studies — to offset the couple's combined active and W-2 income. For a dual-income tech-employee household, the strategy is structurally narrow: it almost always requires one spouse to exit the W-2 workforce (or never have held full-time employment) in order to satisfy the requirement that more than half of the spouse's personal service hours, and at least 750 hours annually, be spent in real property trades or businesses in which the spouse materially participates. The firm's prior scoring of this strategy at 3.

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Dimension	Score	Why
Legal Risk	**3/10**	The statutory and regulatory framework (§469(c)(7), Treas. Reg. §1.469-9, Treas. Reg. §1.469-5T) is well-settled and not itself in doubt, but the fact-intensive hours and material-participation tests are litigated frequently and lost frequently on documentation grounds, including as recently as Mirch, T.C. Memo. 2025-128; audit and disallowance risk is real and recurring, not merely theoretical.
Economic Substance	**6/10**	The strategy rests on genuine economic activity (real property ownership, management, and cost segregation-supported depreciation) rather than a circular or paper transaction, but the tax benefit is front-loaded, subject to later recapture, and dependent on portfolio scale most clients evaluating this strategy have not yet reached.
Realistic ROI	**3/10**	At sub-$2–3M portfolio scale, the tax savings generated do not come close to offsetting the foregone income and benefits of the non-working spouse; ROI only becomes attractive at the roughly $4M+ scale identified in the firm's disposition note, well outside the typical client's current position.
Liquidity	**3/10**	Real estate is illiquid, requires meaningful capital to be deployed and held, and the tax benefit is realized primarily through depreciation rather than cash flow; the household simultaneously loses a salary's worth of liquid income from the non-working spouse.
Client Fit	**4/10**	Fits only a narrow subset of the target client base: a household where one spouse is willing and able to exit the workforce entirely, the couple already has or is prepared to deploy several million dollars into real property, and both spouses will commit to rigorous contemporaneous recordkeeping; the typical dual-W2-income tech household does not match this profile.

Key Risks:

- Audit risk is elevated and durable
- Contemporaneous documentation failure is the single largest risk driver, by a wide margin
- Income-sacrifice risk is structural and specific to this client profile
- Portfolio-scale risk

Recommendation:

Concur with the firm's existing "Not Recommended" disposition for Spousal REPS as a general strategy for the typical high-W2-income tech-employee client. The legal mechanics are sound and the tax benefit, when properly executed, is real — but the strategy imposes a structural requirement (one spouse's exit from active employment) and an unusually strict, litigation-tested documentation burden that make it poorly suited to most clients in this segment, and the economics do not justify the opportunity cost below roughly $3–4 million of deployable real estate capital. Present this strategy only where all of the following are present:

(1) one spouse is independently willing to leave outside employment and treat real estate as their primary occupation

(2) the household has, or is prepared to deploy, several million dollars into depreciable rental real estate

(3) the client is willing to commit to disciplined, real-time contemporaneous hour logs, correctly excluding commuting and third-party-managed time, from day one