

§ 7.465-2

31, 1975, (for the purposes of § 7.465-1 through 7.465-5 such first day shall be referred to as the effective date) shall be determined according to the rules provided in §§ 7.465-2 through 7.465-5.

[T.D. 7504, 42 FR 42197, Aug. 22, 1977]

§ 7.465-2 Determination of amount at risk.

(a) *Initial amount.* The amount a taxpayer is at risk on the effective date with respect to an activity to which section 465 applies shall be determined in accordance with this section. The initial amount the taxpayer is at risk in the activity shall be the taxpayer's initial basis in the activity as modified by disregarding amounts described in section 465(b) (3) or (4) (relating generally to amounts protected against loss or borrowed from related persons).

(b) *Succeeding adjustments.* For each taxable year ending before the effective date, the initial amount at risk shall be increased and decreased by the items which increased and decreased the taxpayer's basis in the activity in that year as modified by disregarding the amounts described in section 465(b) (3) or (4).

(c) *Application of losses and withdrawals.* (1) Losses described in section 465(d) which are incurred in taxable years beginning prior to January 1, 1976 and deducted in such taxable years, will be treated as reducing first that portion of the taxpayer's basis which is attributable to amounts not at risk. On the other hand, withdrawals made in taxable years beginning before January 1, 1976, will be treated as reducing the amount which the taxpayer is at risk.

(2) Therefore, if in a taxable year beginning prior to January 1, 1976 there is a loss described in section 465(d), it shall reduce the amount at risk only to the extent it exceeds the amount of the taxpayer's basis which is not at risk. For the purposes of this paragraph the taxpayer's basis which is not at risk is that portion of the taxpayer's basis in the activity (as of the close of the taxable year and prior to reduction for the loss) which is attributable to amounts described in section 465(b) (3) or (4).

(d) *Amount at risk shall not be less than zero.* If, after determining the amount described in paragraph (a), (b), and (c) of this section, the amount at risk (but

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for this paragraph) would be less than zero, the amount at risk on the effective date shall be zero.

[T.D. 7504, 42 FR 42197, Aug. 22, 1977]

§ 7.465-3 Allocation of loss for different taxable years.

If the taxable year of the entity conducting the activity differs from that of the taxpayer, the loss attributable to the activity for the first taxable year of the entity ending after the beginning of the first taxable year of the taxpayer beginning after December 31, 1975, shall be allocated in the following manner. That portion of the loss from the activity for such taxable year of the entity which bears the same ratio as the number of days in such taxable year before January 1, 1976, divided by the total number of days in the taxable year, shall be attributable to taxable years of the taxpayer beginning before January 1, 1976. Consequently, that portion shall be treated in accordance with § 7.465-2.

[T.D. 7504, 42 FR 42198, Aug. 22, 1977]

§ 7.465-4 Insufficient records.

If sufficient records do not exist to accurately determine under § 7.465-2 the amount which a taxpayer is at risk on the effective date, the amount at risk shall be the taxpayer's basis in the activity reduced (but not below zero) by the taxpayer's share of amounts described in section 465(b) (3) or (4) with respect to the activity on the day before the effective date.

[T.D. 7504, 42 FR 42198, Aug. 22, 1977]

§ 7.465-5 Examples.

The provisions of § 7.465-1 and § 7.465-2 may be illustrated by the following examples:

Example (1). J and K, as equal partners, form partnership JK on January 1, 1975. Partnership JK is engaged solely in an activity described in section 465(c)(1). On January 1, 1975, each partner contributes \$10,000 in cash from personal assets to JK. On July 1, 1975, JK borrows \$40,000 (of which J's share is \$20,000) from a bank under a nonrecourse financing arrangement secured only by the new equipment (for use in the activity) purchased with the \$40,000. On September 1, 1975, JK reduces the amount due on the loan to \$36,000 (of which J's share is \$18,000). On October 1, 1975, JK distributes \$3,000 to each

partner. For taxable year 1975, JK has no income or loss. Although J's basis in the activity is \$25,000 (\$10,000+\$18,000-\$3,000) J's amount at risk on the effective date is \$7,000 determined as follows:

Initial amount at risk	\$10,000
Plus: Items which increased basis other than amounts described in sec. 465(b) (3) or (4)	0
Total	10,000
Less: Distribution	3,000
J's amount at risk on effective date	7,000

Example (2). Assume the same facts as in Example (1) except that JK has a loss (as described in section 465(d) for 1975 of which J's share is \$12,000. Although J's basis in the activity is \$13,000 (\$10,000+\$18,000-\$3,000+\$12,000)) J's amount at risk on the effective date is \$7,000 determined as follows:

Initial amount at risk	\$10,000
Plus: Items which increased basis other than amounts described in sec. 465(b) (3) or (4)	0
Total	10,000
Less: Distribution	3,000
Portion of loss (\$12,000) in excess of portion of basis not at risk (\$18,000)	0
Total	3,000
J's amount at risk on effective date	7,000

Example (3). Assume the same facts as in Example (1) except that JK has a loss (as described in section 465(d) for 1975, and J's share is \$23,000. J's basis in the activity is \$2,000 (\$10,000+\$18,000-\$3,000+\$23,000)). The amount at risk on the effective date is determined as follows:

Initial amount at risk	\$10,000
Plus: Items which increased basis other than amounts described in sec. 465(b) (3) or (4)	0
Total	10,000
Less: Distribution	3,000
Portion of loss (\$23,000) in excess of portion of basis not at risk (\$18,000)	5,000
Total	8,000
J's amount at risk on the effective date	2,000

[T.D. 7504, 42 FR 42198, Aug. 22, 1977]

§ 7.704-1 Partner's distributive share.

- (a)-(c) [Reserved]
- (d) *Limitation on allowance of losses.*
- (1)-(2) [Reserved]
- (3)(i) Section 213(e) of the Tax Reform Act of 1976 amended section 704(d) of the Internal Revenue Code relating to the deductions by partners of losses incurred by a partnership. A partner is entitled to deduct the share of partnership loss to the extent of the adjusted basis of the partner's interest in the

partnership. As amended, section 704(d) provides, in general, that the adjusted basis of a partner's interest in the partnership for the purpose of deducting partnership losses shall not include any portion of a partnership liability for which the partner has no personal liability. This restriction, however, does not apply to any activity to the extent that section 465 of the Code applies nor to any partnership whose principal activity is investing in real property, other than mineral property. Section 465 does not apply to corporations other than a subchapter S corporation or a personal holding company.

(ii) The restrictions in the amendment to section 704(d) will not apply to any corporate partner with respect to liabilities incurred in an activity described in section 465(c)(1). In all other respects the restrictions in the amendment will apply to all corporate partners unless the partnership's principal activity is investment in real property, other than mineral property.

[T.D. 7445, 41 FR 55344, Dec. 20, 1976]

§ 7.936-1 Qualified possession source investment income.

For purposes of this section, interest earned after September 30, 1976 (less applicable deductions), by a domestic corporation, engaged in the active conduct of a trade or business in Puerto Rico, which elects the application of section 936 with respect to deposits with certain Puerto Rican financial institutions will be treated as qualified possession source investment income within the meaning of section 936(d)(2) if (1) the interest qualifies for exemption from Puerto Rican income tax under regulations issued by the Secretary of the Treasury of Puerto Rico, as in effect on September 28, 1976, under the authority of section 2(j) of the Puerto Rico Industrial Incentive Act of 1963, as amended, (2) the interest is from sources within Puerto Rico (within the meaning of section 936(d)(2)(A)), and (3) the funds with respect to which the interest is earned are derived from the active conduct of a trade or business in Puerto Rico or from investment of funds so derived.

[T.D. 7452, 41 FR 56794, Dec. 30, 1976]