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not apply the remedial action provi-
sions under paragraph (h)(8) of this sec-
tion.

[T.D. 8755, 63 FR 673, Jan. 7, 1998; 63 FR 8528,
Feb. 19, 1998, as amended by T.D. 8826, 64 FR
35574, July 1, 1999. Redesignated and amended
by T.D. 8903, 65 FR 57733, Sept. 26, 2000; T.D.
9069, 72 FR 38774, July 16, 2007; T.D. 9495, 75
FR 44904, July 30, 2010; T.D. 9495, 75 FR 52267,
Aug. 25, 2010]

§ 1.1398–1 Treatment of passive activ-
ity losses and passive activity cred-
its in individuals’ title 11 cases.

(a) Scope. This section applies to
cases under chapter 7 or chapter 11 of
title 11 of the United States Code, but
only if the debtor is an individual.

(b) Definitions and rules of general ap-
plication. For purposes of this section—
(1) Passive activity and former passive
activity have the meanings given in sec-
tion 469 (c) and (f)(3);
(2) The unused passive activity loss
(determined as of the first day of a tax-
able year) is the passive activity loss
(as defined in section 469(d)(1)) that is
disallowed under section 469 for the
previous taxable year; and
(3) The unused passive activity credit
(determined as of the first day of a tax-
able year) is the passive activity credit
(as defined in section 469(d)(2)) that is
disallowed under section 469 for the
previous taxable year.

(c) Estate succeeds to losses and credits
upon commencement of case. The bank-
rupcty estate (estate) succeeds to and
takes into account, beginning with its
first taxable year, the debtor’s unused
passive activity loss and unused pas-
sive activity credit (determined as of
the first day of the debtor’s taxable
year in which the case commences).

(d) Transfers from estate to debtor—(1)
Transfer not treated as taxable event. If,
before the termination of the estate,
the estate transfers an interest in a
passive activity or former passive ac-
tivity to the debtor (other than by sale
or exchange), the transfer is not treat-
ed as a disposition for purposes of any
provision of the Internal Revenue Code
assigning tax consequences to a dis-
position. The transfers to which this
rule applies include transfers from the
estate to the debtor of property that is
exempt under section 522 of title 11 of
the United States Code and abandon-
ments of estate property to the debtor
under section 554(a) of such title.

(2) Treatment of passive activity loss
and credit. If, before the termination of
the estate, the estate transfers an in-
terest in a passive activity or former
passive activity to the debtor (other
than by sale or exchange)—

(i) The estate must allocate to the
transferred interest, in accordance
with §1.469–1(f)(4), part or all of the es-
tate’s unused passive activity loss and
unused passive activity credit (deter-
mined as of the first day of the estate’s
taxable year in which the transfer oc-
curs); and

(ii) The debtor succeeds to and takes
into account, beginning with the debt-
or’s taxable year in which the transfer
occurs, the unused passive activity loss
and unused passive activity credit (or
part thereof) allocated to the trans-
ferred interest.

(e) Debtor succeeds to loss and credit of
the estate upon its termination. Upon ter-
mination of the estate, the debtor suc-
ceds to and takes into account, begin-
ning with the debtor’s taxable year in
which the termination occurs, the pas-
sive activity loss and passive activity
credit disallowed under section 469 for
the estate’s last taxable year.

(f) Effective date—(1) Cases commencing
on or after November 9, 1992. This section
applies to cases commencing on or
after November 9, 1992.

(2) Cases commencing before November
9, 1992—(i) Election required. This sec-
tion applies to a case commencing be-
fore November 9, 1992, and terminating
on or after that date if the debtor and
the estate jointly elect its application in
the manner prescribed in paragraph
(f)(2)(v) of this section (the election).
The caption “ELECTION PURSUANT
TO §1.1398–1” must be placed promi-
nently on the first page of each of the
debtor’s returns that is affected by the
election (other than returns for taxable
years that begin after the termination of
the estate) and on the first page of
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each of the estate's returns that is affected by the election. In the case of returns that are amended under paragraph (f)(2)(iii) of this section, this requirement is satisfied by placing the caption on the amended return.

(ii) Scope of election. This election applies to the passive and former passive activities and unused passive activity losses and passive activity credits of the taxpayers making the election.

(iii) Amendment of previously filed returns. The debtor and the estate making the election must amend all returns (except to the extent they are for a year that is a closed year within the meaning of paragraph (f)(2)(iv)(D) of this section) they filed before the date of the election to the extent necessary to provide that no claim of a deduction or credit is inconsistent with the succession under this section to unused losses and credits. The Commissioner may revoke or limit the effect of the election if either the debtor or the estate fails to satisfy the requirement of this paragraph (f)(2)(iii).

(iv) Rules relating to closed years—(A) Estate succeeds to debtor's passive activity loss and credit as of the commencement date. If, by reason of an election under this paragraph (f), this section applies to a case that was commenced in a closed year, the estate, nevertheless, succeeds to and takes into account the unused passive activity loss and unused passive activity credit of the debtor (determined as of the first day of the debtor's taxable year in which the case commenced).

(B) No reduction of unused passive activity loss and credit for passive activity loss or credit to its taxable year following a closed year. In determining a taxpayer's carryover of a passive activity loss or credit to its taxable year following a closed year, a deduction or credit that the taxpayer failed to claim in the closed year, if attributable to an unused passive activity loss or credit to which the taxpayer succeeded under this section, is treated as a deduction or credit that was disallowed under section 469.

(C) Passive activity loss and credit to which taxpayer succeeds reflects deductions of prior holder in a closed year. A loss or credit to which a taxpayer would otherwise succeed under this section is reduced to the extent the loss or credit was allowed to its prior holder for a closed year.

(D) Closed year. For purposes of this paragraph (f)(2)(iv), a taxable year is closed to the extent the assessment of a deficiency or refund of an overpayment is prevented, on the date of the election and at all times thereafter, by any law or rule of law.

(v) Manner of making election—(A) Chapter 7 cases. In a case under chapter 7 of title 11 of the United States Code, the election is made by obtaining the written consent of the bankruptcy trustee and filing a copy of the written consent with the returns (or amended returns) of the debtor and the estate for their first taxable years ending after November 9, 1992.

(B) Chapter 11 cases. In a case under chapter 11 of title 11 of the United States Code, the election is made by incorporating the election into a bankruptcy plan that is confirmed by the bankruptcy court or into an order of such court and filing the pertinent portion of the plan or order with the returns (or amended returns) of the debtor and the estate for their first taxable years ending after November 9, 1992.

(vi) Election is binding and irrevocable. Except as provided in paragraph (f)(2)(iii) of this section, the election, once made, is binding on both the debtor and the estate and is irrevocable.

§ 1.1398–2 Treatment of section 465 losses in individuals' title 11 cases.

(a) Scope. This section applies to cases under chapter 7 or chapter 11 of title 11 of the United States Code, but only if the debtor is an individual.

(b) Definition and rules of general application. For purposes of this section—

(1) Section 465 activity means an activity to which section 465 applies; and

(2) For each section 465 activity, the unused section 465 loss from the activity (determined as of the first day of a taxable year) is the loss (as defined in section 465(d)) that is not allowed under section 465(a)(1) for the previous taxable year.

(c) Estate succeeds to losses upon commencement of case. The bankruptcy estate (the estate) succeeds to and takes into account, beginning with its first