

Internal Revenue Service, Treasury

§ 1.469-1T

(A) The members of the consolidated group shall be treated as one corporation;

(B) Only the outstanding stock of the common parent shall be treated as outstanding stock of the corporation;

(C) An employee of any member of the group shall be treated as an employee of the corporation; and

(D) An activity is treated as the principal activity of the corporation if and only if it is the principal activity (within the meaning of § 1.441-3(e)) of the consolidated group.

(5) [Reserved]

(6) *Intercompany transactions*—(i) *In general.* Section 1.1502-13 applies to determine the treatment under section 469 of intercompany items and corresponding items from intercompany transactions between members of a consolidated group. For example, the matching rule of § 1.1502-13(c) treats the selling member (S) and the buying member (B) as divisions of a single corporation for purposes of determining whether S's intercompany items and B's corresponding items are from a passive activity. Thus, for purposes of applying § 1.469-2(c)(2)(iii) and § 1.469-2T(d)(5)(ii) to property sold by S to B in an intercompany transaction—

(A) S and B are treated as divisions of a single corporation for determining the uses of the property during the 12-month period preceding its disposition to a nonmember, and generally have an aggregate holding period for the property; and

(B) § 1.469-2(c)(2)(iv) does not apply.

(ii) *Example.* The following example illustrates the application of this paragraph (h)(6).

Example. (i) P, a closely held corporation, is the common parent of the P consolidated group. P owns all of the stock of S and B. X is a person unrelated to any member of the P group. S owns and operates equipment that is not used in a passive activity. On January 1 of Year 1, S sells the equipment to B at a gain. B uses the equipment in a passive activity and does not dispose of the equipment before it has been fully depreciated.

(ii) Under the matching rule of § 1.1502-13(c), S's gain taken into account as a result of B's depreciation is treated as gain from a passive activity even though S used the equipment in a nonpassive activity.

(iii) The facts are the same as in paragraph (a) of this Example, except that B sells the

equipment to X on December 1 of Year 3 at a further gain. Assume that if S and B were divisions of a single corporation, gain from the sale to X would be passive income attributable to a passive activity. To the extent of B's depreciation before the sale, the results are the same as in paragraph (ii) of this Example. B's gain and S's remaining gain taken into account as a result of B's sale are treated as attributable to a passive activity.

(iv) The facts are the same as in paragraph (iii) of this Example, except that B recognizes a loss on the sale to X. B's loss and S's gain taken into account as a result of B's sale are treated as attributable to a passive activity.

(iii) *Effective dates.* This paragraph (h)(6) applies with respect to transactions occurring in years beginning on or after July 12, 1995. For transactions occurring in years beginning before July 12, 1995, see § 1.469-1T(h)(6) (as contained in the 26 CFR part 1 edition revised as of April 1, 1995).

(h)(7)–(k) [Reserved]

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§ 1.469-1T General rules (temporary).

(a) *Passive activity loss and credit disallowed*—(1) *In general.* Except as otherwise provided in paragraph (a)(2) of this section—

(i) The passive activity loss for the taxable year shall not be allowed as a deduction; and

(ii) The passive activity credit for the taxable year shall not be allowed.

(2) *Exceptions.* Paragraph (a)(1) of this section shall not apply to the passive activity loss or the passive activity credit for the taxable year to the extent provided in—

(i) Section 469(i) and the rules to be contained in § 1.469-9T (relating to losses and credits attributable to certain rental real estate activities); and

(ii) Section 1.469-11T (relating to losses and credits attributable to certain pre-enactment interests in activities).

(b) *Taxpayers to whom these rules apply.* The rules of section 469 and the regulations thereunder generally apply to—

(1) Individuals;

§ 1.469-1T

26 CFR Ch. I (4-1-16 Edition)

(2) Trusts (other than trusts (or portions of trusts) described in section 671);

(3) Estates;

(4) Personal service corporations (within the meaning of paragraph (g)(2)(i) of this section); and

(5) Closely held corporations (within the meaning of paragraph (g)(2)(ii) of this section).

(c) *Cross references*—(1) *Definition of “passive activity.”* Rules relating to the definition of the term “passive activity” are contained in paragraph (e) of this section.

(2) *Passive activity loss.* Rules relating to the computation of the passive activity loss for the taxable year are contained in § 1.469-2T.

(3) *Passive activity credit.* Rules relating to the computation of the passive activity credit for the taxable year are contained in § 1.469-3T.

(4) *Effect of rules for other purposes.* Rules relating to the effect of section 469 and the regulations thereunder for other purposes under the Code are contained in paragraph (d) of this section.

(5) *Special rule for oil and gas working interests.* Rules relating to the treatment of losses and credits from certain interests in oil and gas wells are contained in paragraph (e)(4) of this section.

(6) *Treatment of disallowed losses and credits.* Paragraph (f) of this section contains rules relating to—

(i) The treatment of deductions from passive activities in taxable years in which the passive activity loss is disallowed in whole or in part under paragraph (a)(1)(i) of this section; and

(ii) The treatment of credits from passive activities in taxable years in which the passive activity credit is disallowed in whole or in part under paragraph (a)(1)(ii) of this section.

(7) *Corporation subject to section 469.* Rules relating to the application of section 469 and regulations thereunder to C corporations are contained in paragraph (g) of this section.

(8) [Reserved]

(9) *Joint returns.* Rules relating to the application of section 469 and the regulations thereunder to spouses filing a joint return for the taxable year are contained in paragraph (j) of this section.

(10) *Material participation.* Rules defining the term “material participation” are contained in § 1.469-5T.

(11) *Effective date and transition rules.* Rules relating to the effective date of section 469 and the regulations thereunder and transition rules applicable to pre-enactment interests in activities are contained in § 1.469-11T.

(12) *Future regulations.* (i) Rules relating to former passive activities and changes in corporate status will be contained in paragraph (k) of this section.

(ii) Rules relating to the definition of “activity” will be contained in § 1.469-4T.

(iii) Rules relating to the treatment of deductions from activities that are disposed of in certain transactions will be contained in § 1.469-6T.

(iv) Rules relating to the treatment of self-charged items of income and expense will be contained in § 1.469-7T.

(v) Rules relating to the application of section 469 and the regulations thereunder to trusts, estates, and their beneficiaries will be contained in § 1.469-8T.

(vi) Rules relating to the treatment of income, deductions, and credits from certain rental real estate activities of individuals and certain estates will be contained in § 1.469-9T.

(vii) Rules relating to the application of section 469 to publicly traded partnerships will be contained in § 1.469-10T.

(d) *Effect of section 469 and the regulations thereunder for other purposes*—(1) *Treatment of items of passive activity income and gain.* Neither the provisions of section 469 (a)(1) and paragraph (a)(1) of this section nor the characterization of items of income or deduction as passive activity gross income (within the meaning of § 1.469-2T (c)) or passive activity deductions (within the meaning of § 1.469-2T (d)) affects the treatment of any item of income or gain under any provision of the Internal Revenue Code other than section 469. The following example illustrates the application of this paragraph (d)(1):

Example. (i) In 1991, an individual’s only income and loss from passive activities are a \$10,000 capital gain from passive activity X

and a \$12,000 ordinary loss from passive activity Y. The taxpayer also has a \$10,000 capital loss that is not derived from a passive activity.

(ii) Under § 1.469-2T (b), the taxpayer has a \$2,000 passive activity loss for the taxable year. The only effect of section 469 and the regulations thereunder is to disallow a deduction for the taxpayer's \$2,000 passive activity loss for the taxable year. Thus, the taxpayer's capital loss for the taxable year is allowed because the \$10,000 capital gain from passive activity X is taken into account under section 1211 (b) in computing the taxpayer's allowable capital loss for the year.

(2) *Coordination with sections 613A(d) and 1211.* [Reserved]. See § 1.469-1(d)(2) for rules relating to this paragraph.

(3) *Treatment of passive activity losses.* Except as otherwise provided by regulations, a deduction that is disallowed for a taxable year under section 469 and the regulations thereunder is not taken into account as a deduction that is allowed for the taxable year in computing the amount subject to any tax imposed by subtitle A of the Internal Revenue Code. The following example illustrates the application of this paragraph (d)(3):

Example. An individual has a \$5,000 passive activity loss for a taxable year, all of which is disallowed under paragraph (a)(1) of this section. All of the disallowed loss is allocated under paragraph (f) of this section to activities that are trades or businesses (within the meaning of section 1402(c)). Such loss is not taken into account for the taxable year in computing the taxpayer's taxable income subject to tax under section 1. In addition, under this paragraph (d)(3), such loss is not taken into account for the taxable year in computing the taxpayer's net earnings from self-employment subject to tax under section 1401.

(e) *Definition of "passive activity"*—(1) *In general.* Except as otherwise provided in this paragraph (e), an activity is a passive activity of the taxpayer for a taxable year if and only if the activity—

(i) Is a trade or business activity (within the meaning of paragraph (e)(2) of this section) in which the taxpayer does not materially participate for such taxable year; or

(ii) Is a rental activity (within the meaning of paragraph (e)(3) of this section), without regard to whether or to what extent the taxpayer participates in such activity.

(2) *Trade or business activity.* [Reserved]. See § 1.469-1(e)(2) for rules relating to this paragraph.

(3) *Rental activity*—(i) *In general.* Except as otherwise provided in this paragraph (e)(3), an activity is a rental activity for a taxable year if—

(A) During such taxable year, tangible property held in connection with the activity is used by customers or held for use by customers; and

(B) The gross income attributable to the conduct of the activity during such taxable year represents (or, in the case of an activity in which property is held for use by customers, the expected gross income from the conduct of the activity will represent) amounts paid or to be paid principally for the use of such tangible property (without regard to whether the use of the property by customers is pursuant to a lease or pursuant to a service contract or other arrangement that is not denominated a lease).

(ii) *Exceptions.* For purposes of this paragraph (e)(3), an activity involving the use of tangible property is not a rental activity for a taxable year if for such taxable year—

(A) The average period of customer use for such property is seven days or less;

(B) The average period of customer use for such property is 30 days or less, and significant personal services (within the meaning of paragraph (e)(3)(iv) of this section) are provided by or on behalf of the owner of the property in connection with making the property available for use by customers;

(C) Extraordinary personal services (within the meaning of paragraph (e)(3)(v) of this section) are provided by or on behalf of the owner of the property in connection with making such property available for use by customers (without regard to the average period of customer use);

(D) The rental of such property is treated as incidental to a nonrental activity of the taxpayer under paragraph (e)(3)(vi) of this section;

(E) The taxpayer customarily makes the property available during defined business hours for nonexclusive use by various customers; or

(F) The provision of the property for use in an activity conducted by a partnership, S corporation, or joint venture in which the taxpayer owns an interest is not a rental activity under paragraph (e)(3)(vii) of this section.

(iii) *Average period of customer use.* [Reserved]. See § 1.469-1(e)(3)(iii) for rules relating to this paragraph.

(iv) *Significant personal services—(A) In general.* For purposes of paragraph (e)(3)(ii)(B) of this section, personal services include only services performed by individuals, and do not include excluded services (within the meaning of paragraph (e)(3)(iv)(B) of this section). In determining whether personal services provided in connection with making property available for use by customers are significant, all of the relevant facts and circumstances shall be taken into account. Relevant facts and circumstances include the frequency with which such services are provided, the type and amount of labor required to perform such services, and the value of such services relative to the amount charged for the use of the property.

(B) *Excluded services.* For purposes of paragraph (e)(3)(iv)(A) of this section, the term “excluded services” means, with respect to any property made available for use by customers—

(1) Services necessary to permit the lawful use of the property;

(2) Services performed in connection with the construction of improvements to the property, or in connection with the performance of repairs that extend the property’s useful life for a period substantially longer than the average period for which such property is used by customers; and

(3) Services, provided in connection with the use of any improved real property, that are similar to those commonly provided in connection with long-term rentals of high-grade commercial or residential real property (e.g., cleaning and maintenance of common areas, routine repairs, trash collection, elevator service, and security at entrances or perimeters).

(v) *Extraordinary personal services.* For purposes of paragraph (e)(3)(ii)(C) of this section, extraordinary personal services are provided in connection with making property available for use

by customers only if the services provided in connection with the use of the property are performed by individuals, and the use by customers of the property is incidental to their receipt of such services. For example, the use by patients of a hospital’s boarding facilities generally is incidental to their receipt of the personal services provided by the hospital’s medical and nursing staff. Similarly, the use by students of a boarding school’s dormitories generally is incidental to their receipt of the personal services provided by the school’s teaching staff.

(vi) *Rental of property incidental to a nonrental activity of the taxpayer—(A) In general.* For purposes of paragraph (e)(3)(ii)(D) of this section, the rental of property shall be treated as incidental to a nonrental activity of the taxpayer only to the extent provided in this paragraph (e)(3)(vi).

(B) *Property held for investment.* The rental of property during a taxable year shall be treated as incidental to an activity of holding such property for investment if and only if—

(1) The principal purpose for holding the property during such taxable year is to realize gain from the appreciation of the property (without regard to whether it is expected that such gain will be realized from the sale or exchange of the property in its current state of development); and

(2) The gross rental income from the property for such taxable year is less than two percent of the lesser of—

(i) The unadjusted basis of such property; and

(ii) The fair market value of such property.

(C) *Property used in a trade or business.* The rental of property during a taxable year shall be treated as incidental to a trade or business activity (within the meaning of paragraph (e)(2) of this section) if and only if—

(1) The taxpayer owns an interest in such trade or business activity during the taxable year;

(2) The property was predominantly used in such trade or business activity during the taxable year or during at least two of the five taxable years that immediately precede the taxable year; and

(3) The gross rental income from such property for the taxable year is less than two percent of the lesser of—

(i) The unadjusted basis of such property; and

(ii) The fair market value of such property.

(D) *Lodging for convenience of employer.* [Reserved]. See § 1.469-1(e)(3)(vi)(D) for rules relating to this paragraph.

(E) *Unadjusted basis.* [Reserved]. See § 1.469-1(e)(3)(vi)(E) for rules relating to this paragraph.

(vii) *Property made available for use in a nonrental activity conducted by a partnership, S corporation, or joint venture in which the taxpayer owns an interest.* If the taxpayer owns an interest in a partnership, S corporation, or joint venture conducting an activity other than a rental activity, and the taxpayer provides property for use in the activity in the taxpayer's capacity as an owner of an interest in such partnership, S corporation, or joint venture, the provision of such property is not a rental activity. Thus, if a partner contributes the use of property to a partnership, none of the partner's distributive share of partnership income is income from a rental activity unless the partnership is engaged in a rental activity. In addition, a partner's gross income attributable to a payment described in section 707(c) is not income from a rental activity under any circumstances (see § 1.469-2T (e)(2)). The determination of whether property used in an activity is provided by the taxpayer in the taxpayer's capacity as an owner of an interest in a partnership, S corporation, or joint venture shall be made on the basis of all of the facts and circumstances.

(viii) *Examples.* The following examples illustrate the application of this paragraph (e)(3):

Example 1. The taxpayer is engaged in an activity of leasing photocopying equipment. The average period of customer use for the equipment exceeds 30 days. Pursuant to the lease agreements, skilled technicians employed by the taxpayer maintain the equipment and service malfunctioning equipment for no additional charge. Service calls occur frequently (three times per week on average) and require substantial labor. The value of the maintenance and repair services (measured by the cost to the taxpayer of employ-

ees performing these services) exceeds 50 percent of the amount charged for the use of the equipment. Under these facts, services performed by individuals are provided in connection with the use of the photocopying equipment, but the customers' use of the photocopying equipment is not incidental to their receipt of the services. Therefore, extraordinary personal services (within the meaning of paragraph (e)(3)(v) of this section) are not provided in connection with making the photocopying equipment available for use by customers, and the activity is a rental activity.

Example 2. The facts are the same as in Example 1, except that the average period of customer use for the photocopying equipment exceeds seven days but does not exceed 30 days. Under these facts, significant personal services (within the meaning of paragraph (e)(3)(iv) of this section) are provided in connection with making the photocopying equipment available for use by customers and, under paragraph (e)(3)(ii)(B) of this section, the activity is not a rental activity.

Example 3. The taxpayer is engaged in an activity of transporting goods for customers. In conducting the activity, the taxpayer provides tractor-trailers to transport goods for customers pursuant to arrangements under which the tractor-trailers are selected by the taxpayer, may be replaced at the sole option of the taxpayer, and are operated and maintained by drivers and mechanics employed by the taxpayer. The average period of customer use for the tractor-trailers exceeds 30 days. Under these facts, the use of tractor-trailers by the taxpayer's customers is incidental to their receipt of personal services provided by the taxpayer. Accordingly, the services performed in the activity are extraordinary personal services (within the meaning of paragraph (e)(3)(v) of this section) and, under paragraph (e)(3)(ii)(C) of this section, the activity is not a rental activity.

Example 4. The taxpayer is engaged in an activity of owning and operating a residential apartment hotel. For the taxable year, the average period of customer use for apartments exceeds seven days but does not exceed 30 days. In addition to cleaning public entrances, exits, stairways, and lobbies, and collecting and removing trash, the taxpayer provides a daily maid and linen service at no additional charge. All of the services other than maid and linen service are excluded services (within the meaning of paragraph (e)(3)(iv)(B) of this section), because such services are similar to those commonly provided in connection with long-term rentals of high-grade residential real property. The value of the maid and linen services (measured by the cost to the taxpayer of employees performing such services) is less than 10 percent of the amount charged to tenants for occupancy of apartments. Under these facts, neither significant personal services (within

the meaning of paragraph (e)(3)(iv) of this section) nor extraordinary personal services (within the meaning of paragraph (e)(3)(v) of this section) are provided in connection with making apartments available for use by customers. Accordingly, the activity is a rental activity.

Example 5. The taxpayer owns 1,000 acres of unimproved land with a fair market value of \$350,000 and an unadjusted basis of \$210,000. The taxpayer holds the land for the principal purpose of realizing gain from appreciation. In order to defray the cost of carrying the land, the taxpayer leases the land to a rancher, who uses the land to graze cattle and pays rent of \$4,000 per year. Thus, the gross rental income from the land is less than two percent of the lesser of the fair market value and the unadjusted basis of the land ($.02 \times \$210,000 = \$4,200$). Accordingly, under paragraph (e)(3)(ii)(D) of this section, the rental of the land is not a rental activity because the rental is treated under paragraph (e)(3)(vi)(B) of this section as incidental to an activity of holding the property for investment.

Example 6. (i) A calendar year taxpayer owns an interest in a farming activity which is a trade or business activity (within the meaning of paragraph (e)(2) of this section) and owns farmland which was used in the farming activity in 1985 and 1986. The fair market value of the farmland is \$350,000 and its unadjusted basis is \$210,000. In 1987, 1988, and 1989, the taxpayer continues to own an interest in the farming activity but does not use the land in the activity. In 1987, the taxpayer leases the land for \$4,000 to a rancher, who uses the land to graze cattle. In 1988, the taxpayer leases the land for \$10,000 to a film production company, which uses the land to film scenes for a movie. In 1989, the taxpayer again leases the land for \$4,000 to the rancher.

(ii) For 1987 and 1989, the taxpayer owns an interest in a trade or business activity, and the farmland which the taxpayer leases to the rancher was used in such activity for two out of the five immediately preceding taxable years. In addition, the gross rental income from the land (\$4,000) is less than two percent of the lesser of the fair market value and the unadjusted basis of the land ($.02 \times \$210,000 = \$4,200$). Accordingly, the taxpayer's rental of the land is treated under paragraph (e)(3)(vi)(C) of this section as incidental to the taxpayer's farming activity, and is not a rental activity.

(iii) Because the taxpayer's gross rental income from the land for 1988 (\$10,000) is not less than two percent of the lesser of the fair market value and the unadjusted basis of the land, the requirement of paragraph (e)(3)(vi)(C)(3) of this section is not met. Therefore, the taxpayer's rental of the land in 1988 is not treated as incidental to the

taxpayer's farming activity and is a rental activity.

Example 7. (i) In 1988, the taxpayer acquires vacant land for the purpose of constructing a shopping mall. Before commencing construction, the taxpayer leases the land under a one-year lease to an automobile dealer, who uses the land to park cars held in its inventory. The taxpayer commences construction of the shopping mall in 1989.

(ii) The taxpayer acquired the land for the principal purpose of constructing the shopping mall, not for the principal purpose of realizing gain from the appreciation of the property. Therefore, the rental of the property in 1988 is not treated under paragraph (e)(3)(vi)(B) of this section as incidental to an activity of holding the property for investment.

(iii) The land has not been used in any taxable year in any trade or business of the taxpayer. Therefore, the rental of the property in 1988 is not treated under paragraph (e)(3)(vi)(C) of this section as incidental to a trade or business activity.

(iv) Since the rental of the land in 1988 is not treated under paragraph (e)(3)(vi) of this section as incidental to a nonrental activity of the taxpayer, the rental of the land in 1988 is a rental activity. See § 1.469-2T(f)(3) for a special rule relating to the treatment of gross income from the rental of nondepreciable property.

Example 8. The taxpayer makes farmland available to a tenant farmer pursuant to an arrangement designated a "crop-share lease." Under the arrangement, the tenant is required to use the tenant's best efforts to farm the land and produce marketable crops. The taxpayer is obligated to pay 50 percent of the costs incurred in the activity (without regard to whether any crops are successfully produced or marketed), and is entitled to 50 percent of the crops produced (or 50 percent of the proceeds from marketing the crops). For purposes of paragraph (e)(3)(vii) of this section, the taxpayer is treated as providing the farmland for use in a farming activity conducted by a joint venture in the taxpayer's capacity as an owner of an interest in the joint venture. Accordingly, under paragraph (e)(3)(ii)(F) of this section, the taxpayer is not engaged in a rental activity, without regard to whether the taxpayer performs any services in the farming activity.

Example 9. The taxpayer owns a taxicab which the taxpayer operates during the day and leases to another driver for use at night under a one-year lease. Under the terms of the lease, the other driver is charged a fixed rental for use of the taxicab. Assume that, under the rules to be contained in § 1.469-4T, the taxpayer is engaged in two separate activities, an activity of operating the taxicab and an activity of making the taxicab available for use by the other driver. Under these facts, the period for which the other driver

uses the taxicab exceeds 30 days, and the taxpayer does not provide extraordinary personal services in connection with making the taxicab available to the other driver. Accordingly, the lease of the taxicab is a rental activity.

Example 10. The taxpayer operates a golf course. Some customers of the golf course pay green fees upon each use of the golf course, while other customers purchase weekly, monthly, or annual passes. The golf course is open to all customers from sunrise to sunset every day of the year except certain holidays and days on which the taxpayer determines that the course is too wet for play. The taxpayer thus makes the golf course available during prescribed hours for nonexclusive use by various customers. Accordingly, under paragraph (e)(3)(ii)(E) of this section, the taxpayer is not engaged in a rental activity, without regard to the average period of customer use for the golf course.

(4) *Special rule for oil and gas working interests*—(i) *In general.* Except as otherwise provided in paragraph (e)(4)(ii) of this section, an interest in an oil or gas well drilled or operated pursuant to a working interest (within the meaning of paragraph (e)(4)(iv) of this section) of a taxpayer is not an interest in a passive activity for the taxpayer's taxable year (without regard to whether the taxpayer materially participates in such activity) if at any time during such taxable year the taxpayer holds such working interest either—

(A) Directly; or

(B) Through an entity that does not limit the liability of the taxpayer with respect to the drilling or operation of such well pursuant to such working interest.

(ii) *Exception for deductions attributable to a period during which liability is limited*—(A) *In general.* If paragraph (e)(4)(i) of this section applies for a taxable year to the taxpayer's interest in an oil or gas well that would, but for the application of paragraph (e)(4)(i) of this section, by an interest in a passive activity for the taxable year, and the taxpayer has a net loss (within the meaning of paragraph (e)(4)(ii)(C)(3) of this section) from the well for the taxable year—

(1) The taxpayer's disqualified deductions (within the meaning of paragraph (e)(4)(ii)(C)(2) of this section) from such oil or gas well for such year shall be treated as passive activity deductions

for such year (within the meaning of § 1.469-2T(d)); and

(2) A ratable portion (within the meaning of paragraph (e)(4)(ii)(C)(4) of this section) of the taxpayer's gross income from such oil or gas well for such year shall be treated as passive activity gross income for such year (within the meaning of § 1.469-2T(c)).

(B) *Coordination with rules governing the identification of disallowed passive activity deductions.* If gross income and deductions from an activity for a taxable year are treated as passive activity gross income and passive activity deductions under paragraph (e)(4)(ii)(A) of this section, such activity shall be treated as a passive activity for such year for purposes of applying paragraph (f) (2) and (4) of this section.

(C) *Meaning of certain terms.* For purposes of this paragraph (e)(4)(ii), the following terms shall have the meanings set forth below:

(1) *Allocable deductions.* The deductions allocable to a taxable year are any deductions that arise in such year (within the meaning of § 1.469-2T (d)(8)) and any deductions that are treated as deductions for such year under paragraph (f)(4) of this section.

(2) *Disqualified deductions.* The taxpayer's "disqualified deductions" from an oil or gas well for a taxable year are the taxpayer's deductions—

(i) That are attributable to such well and allocable to the taxable year; and

(ii) With respect to which economic performance (within the meaning of section 461(h), without regard to section 461(h)(3) or (i)(2)) occurs at a time during which the taxpayer's only interest in the working interest is held through an entity that limits the taxpayer's liability with respect to the drilling or operation of such well.

(3) *Net loss.* The "net loss" of a taxpayer from an oil or gas well for a taxable year equals the amount by which the taxpayer's deductions that are attributable to such oil or gas well and allocable to such year exceeds the gross income of the taxpayer from such well for such year.

(4) *Ratable portion.* The "ratable portion" of the taxpayer's gross income from an oil or gas well for a taxable year equals the total amount of such

gross income multiplied by the fraction obtained by dividing—

(i) The disqualified deductions from such oil or gas well for the taxable year; by

(ii) The total amount of the deductions that are attributable to such oil or gas well and allocable to the taxable year.

(iii) *Examples.* The following examples illustrate the application of paragraphs (e)(4) (i) and (ii) of this section:

Example 1. (i) A, a calendar year individual, acquires on January 1, 1987, a general partnership interest in P, a calendar year partnership that holds a working interest in an oil or gas property. Pursuant to the partnership agreement, A is entitled to convert the general partnership interest into a limited partnership interest at any time. On December 1, 1987, pursuant to a contract with D, an independent drilling contractor, P commences drilling a single well pursuant to the working interest. Under the drilling contract, P pays D for the drilling only as the work is performed. All drilling costs are deducted by P in the year in which they are paid. At the end of 1987, A converts the general partnership interest into a limited partnership interest, effective immediately. The drilling of the well is completed on February 28, 1988. A's interest in the well would but for this paragraph (e)(4) be an interest in a passive activity.

(ii) Throughout 1987, A holds the working interest through an entity that does not limit A's liability with respect to the drilling of the well pursuant to the working interest. In 1988, however, A holds the working interest through an entity that limits A's liability with respect to the drilling and operation of the well throughout such year. Accordingly, under paragraph (e)(4)(i) of this section, A's interest in P's well is not an interest in a passive activity for 1987 but is an interest in a passive activity for 1988. Moreover, since economic performance occurs in 1987 with respect to all items of deduction for drilling costs that are allocable to 1987, A has no disqualified deductions for 1987.

Example 2. The facts are the same as in Example 1, except that all costs of drilling under the contract with D (including costs of drilling performed after 1987) are paid before the end of 1987 and A has a net loss for 1987. In addition, A has \$15,000 of total deductions that are attributable to the well and allocable to 1987, but economic performance (as that term is used in paragraph (e)(4)(ii)(C)(2)(ii) of this section) does not occur with respect to \$5,000 of those deductions until 1988. Under paragraph (e)(4)(ii) of this section, the \$5,000 of deductions with respect to which economic performance occurs in 1988 are disqualified deductions and are

treated as passive activity deductions for 1987. In addition, one-third (\$5,000/\$15,000) of A's gross income from the well for 1987 is treated as passive activity gross income.

(iv) *Definition of "working interest."* [Reserved]. See §1.469-1(e)(4)(iv) for rules relating to this paragraph.

(v) *Entities that limit liability*—(A) *General rule.* For purposes of paragraph (e)(4)(i)(B) of this section, an entity limits the liability of the taxpayer with respect to the drilling or operation of a well pursuant to a working interest held through such entity if the taxpayer's interest in the entity is in the form of—

(1) A limited partnership interest in a partnership in which the taxpayer is not a general partner;

(2) Stock in a corporation; or

(3) An interest in any entity (other than a limited partnership or corporation) that, under applicable State law, limits the potential liability of a holder of such an interest for all obligations of the entity to a determinable fixed amount (for example, the sum of the taxpayer's capital contributions).

(B) *Other limitations disregarded.* For purposes of this paragraph (e)(4), protection against loss through any of the following is not taken into account in determining whether a taxpayer holds a working interest through an entity that limits the taxpayer's liability:

(1) An indemnification agreement;

(2) A stop loss arrangement;

(3) Insurance;

(4) Any similar arrangement; or

(5) Any combination of the foregoing.

(C) *Examples.* The following examples illustrate the application of this paragraph (e)(4)(v):

Example 1. A owns a 20 percent interest as a general partner in the capital and profits of P, a partnership which owns oil or gas working interests. The other partners of P agree to indemnify A against liability in excess of A's capital contribution for any of P's costs and expenses with respect to P's working interests. As a general partner, however, A is jointly and severally liable for all of P's liabilities and, under paragraph (e)(4)(v)(B)(1) of this section, the indemnification agreement is not taken into account in determining whether A holds the working interests through an entity that limits A's liability. Accordingly, the partnership does not limit A's liability with respect to the drilling or operation of wells pursuant to the working interests.

Example 2. B owns a 10 percent interest in X, an entity (other than a limited partnership or corporation) created under applicable State law to hold working interests in oil or gas properties. Under applicable State law, B is liable without limitation for 10 percent of X's costs and expenses with respect to X's working interests but is not liable for the remaining 90 percent of such costs and expenses. Since B's liability for the obligations of X is not limited to a determinable fixed amount (within the meaning of paragraph (e)(4)(v)(A)(3) of this section), the entity does not limit B's liability with respect to the drilling or operation of wells pursuant to the working interests.

Example 3. C is both a general partner and a limited partner in a partnership that owns a working interest in oil or gas property. Because C owns an interest as a general partner in each well drilled pursuant to the working interest, C's entire interest in each well drilled pursuant to the working interest is treated under paragraph (e)(4)(i) of this section as an interest in an activity that is not a passive activity (without regard to whether C materially participates in such activity).

(vi) *Cross reference to special rule for income from certain oil or gas properties.* A special rule relating to the treatment of income from certain interests in oil or gas properties is contained in § 1.469-2T(c)(6).

(5) *Rental of dwelling unit.* [Reserved]. See § 1.469-2(d)(2)(xii) for rules relating to this paragraph.

(6) *Activity of trading personal property—(i) In general.* An activity of trading personal property for the account of owners of interests in the activity is not a passive activity (without regard to whether such activity is a trade or business activity (within the meaning of paragraph (e)(2) of this section)).

(ii) *Personal property.* For purposes of this paragraph (e)(6), the term "personal property" means personal property (within the meaning of section 1092(d), without regard to paragraph (3) thereof).

(iii) *Example.* The following example illustrates the application of this paragraph (e)(6):

Example. A partnership is a trader of stocks, bonds, and other securities (within the meaning of section 1236(c)). The capital employed by the partnership in the trading activity consists of amounts contributed by the partners in exchange for their partnership interests, and funds borrowed by the partnership. The partnership derives gross

income from the activity in the form of interest, dividends, and capital gains. Under these facts, the partnership is treated as conducting an activity of trading personal property for the account of its partners. Accordingly, under this paragraph (e)(6), the activity is not a passive activity.

(f) *Treatment of disallowed passive activity losses and credits—(1) Scope of this paragraph.* The rules in this paragraph (f)—

(i) Identify the passive activity deductions that are disallowed for any taxable year in which all or a portion of the taxpayer's passive activity loss is disallowed under paragraph (a)(1)(i) of this section;

(ii) Identify the credits from passive activities that are disallowed for any taxable year in which all or a portion of the taxpayer's passive activity credit is disallowed under paragraph (a)(1)(i) of this section; and

(iii) Provide for the carryover of disallowed deductions and credits.

(2) *Identification of disallowed passive activity deductions—(i) Allocation of disallowed passive activity loss among activities—(A) General rule.* If all or any portion of the taxpayer's passive activity loss is disallowed for the taxable year under paragraph (a)(1)(i) of this section, a ratable portion of the loss (if any) from each passive activity of the taxpayer is disallowed. For purposes of the preceding sentence, the ratable portion of a loss from an activity is computed by multiplying the passive activity loss that is disallowed for the taxable year by the fraction obtained by dividing—

(1) The loss from the activity for the taxable year; by

(2) The sum of the losses for the taxable year from all activities having losses for such year.

(B) *Loss from an activity.* For purposes of this paragraph (f)(2)(i), the term "loss from an activity" means—

(1) The amount by which the passive activity deductions from the activity for the taxable year (within the meaning of § 1.469-2T(d)) exceed the passive activity gross income from the activity for the taxable year (within the meaning of § 1.469-2T(c)); reduced by

(2) Any part of such amount that is allowed under section 469(i) and the

§ 1.469-1T

26 CFR Ch. I (4-1-16 Edition)

rules to be contained in § 1.469-9T (relating to the \$25,000 allowance for certain rental real estate activities).

(C) *Significant participation passive activities.* If the taxpayer's passive activity gross income from significant participation passive activities (within the meaning of § 1.469-2T(f)(2)(ii)) for the taxable year (determined without regard to § 1.469-2T(f)(2) through (4)) exceeds the taxpayer's passive activity deductions from such activities for the

taxable year, such activities shall be treated, solely for purposes of applying this paragraph (f)(2)(i) for the taxable year, as a single activity that does not have a loss for such taxable year.

(D) *Examples.* The following examples illustrate the application of this paragraph (f)(2)(i):

Example 1. An individual holds interests in three passive activities, A, B, and C. The gross income and deductions from these activities for the taxable year are as follows:

	A	B	C	Total
Gross income	\$7,000	\$4,000	\$12,000	\$23,000
Deductions	(16,000)	(20,000)	(8,000)	(44,000)
Net income (loss)	(\$9,000)	(\$16,000)	\$4,000	(\$21,000)

The taxpayer's \$21,000 passive activity loss for the taxable year is disallowed under paragraph (a)(1)(i) of this section. Therefore, a ratable portion of the losses from activities A and B is disallowed. The disallowed portion of each loss is determined as follows:

A: $\$21,000 \times \$9,000/\$25,000$ \$7,560

B: $\$21,000 \times \$16,000/\$25,000$ \$13,440
 Total \$21,000

Example 2. An individual holds interests in four passive activities, A, B, C, and D. The results of operations of these activities for the taxable year are as follows:

	A	B	C	D	Total
Gross income	15,000	5,000	10,000	10,000	40,000
Deductions	(5,000)	(10,000)	(20,000)	(8,000)	(43,000)
Net income (loss)	10,000	(5,000)	(10,000)	2,000	(3,000)

Activities A and B are significant participation passive activities (within the meaning of § 1.469-2T(f)(2)(ii)). The gross income from these activities for the taxable year (\$20,000) exceeds the passive activity deductions from those activities for the taxable year (\$15,000) by \$5,000 and, under § 1.469-2T(f)(2), \$5,000 of gross income from those activities is treated as not from a passive activity. Therefore, solely for purposes of applying this paragraph (f)(2)(i) for the taxable year, activities A and B are treated as a single activity that does not have a loss for the taxable year. Under § 1.469-2T(b), the taxpayer's passive activity loss for the taxable year is \$8,000 (\$43,000 of passive activity deductions minus \$35,000 of passive activity gross income). The results of treating activities A and B as a single activity that does not have a loss for the taxable year is that none of the \$8,000 passive activity loss is allocated under this paragraph (f)(2)(i) to activity B for the taxable year, even though the taxpayer incurred a loss in that activity for the taxable year.

(ii) *Allocation within loss activities—(A) In general.* If all or any portion of a taxpayer's loss from an activity is dis-

allowed under paragraph (f)(2)(i) of this section for the taxable year, a ratable portion of each passive activity deduction (other than an excluded deduction (within the meaning of paragraph (f)(2)(ii)(B) of this section)) of the taxpayer from such activity is disallowed. For purposes of the preceding sentence, the ratable portion of a passive activity deduction of a taxpayer is the amount of the disallowed portion of the taxpayer's loss from the activity (within the meaning of paragraph (f)(2)(i)(B) of this section) for the taxable year multiplied by the fraction obtained by dividing—

- (1) The amount of such deduction; by
- (2) The sum of all passive activity deductions (other than excluded deductions (within the meaning of paragraph (f)(2)(ii)(B) of this section)) of the taxpayer from such activity from the taxable year.

(B) *Excluded deductions.* The term "excluded deduction" means any passive activity deduction of a taxpayer

that is taken into account in computing the taxpayer's net income from an item of property for a taxable year in which an amount of the taxpayer's gross income from such item of property is treated as not from a passive activity under § 1.469-2T(c)(6) or § 1.469-2T(f) (5), (6), or (7).

(iii) *Separately identified deductions.* In identifying the deductions from an activity that are disallowed under this paragraph (f)(2), the taxpayer need not account separately for a deduction unless such deduction may, if separately taken into account, result in an income tax liability for any taxable year different from that which would result were such deduction not taken into account separately. For related rules applicable to partnerships and S corporations, see § 1.702-1(a)(8)(ii) and section 1366(a)(1)(A), respectively. Deductions that must be accounted for separately include (but are not limited to) deductions that—

(A) Arise in a rental real estate activity (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T) in taxable years in which the taxpayer actively participates (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T) in such activity;

(B) Arise in a rental real estate activity (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T) in taxable years in which the taxpayer does not actively participate (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T) in such activity; or

(C) Are taken into account under section 1211 (relating to the limitation on capital losses) or section 1231 (relating to property used in a trade or business and involuntary conversions).

(3) *Identification of disallowed credits from passive activities—(i) General rule.* If all or any portion of the taxpayer's passive activity credit is disallowed for the taxable year under paragraph (a)(1)(ii) of this section, a ratable portion of each credit from each passive activity of the taxpayer is disallowed. For purposes of the preceding sentence, the ratable portion of a credit of a taxpayer is computed by multiplying the portion of the taxpayer's passive activity credit that is disallowed for the

taxable year by the fraction obtained by dividing—

(A) The amount of the credit; by

(B) The sum of all of the taxpayer's credits from passive activities for the taxable year.

(ii) *Coordination rule.* For purposes of paragraph (f)(3)(i) of this section, the credits from a passive activity do not include any credit or portion of a credit that—

(A) Is allowed for the taxable year under section 469(i) and the rules to be contained in § 1.469-9T (relating to the \$25,000 allowance for certain rental real estate activities); or

(B) Increases the basis of property during the taxable year under section 469(j)(9) and the rules to be contained in § 1.469-6T (relating to the election to increase the basis of certain property by disallowed credits).

(iii) *Separately identified credits.* In identifying the credits from an activity that are disallowed under this paragraph (f)(3), the taxpayer need not account separately for any credit unless such credit may, if separately taken into account, result in an income tax liability for any taxable year different from that which would result were such credit not taken into account separately. For related rules applicable to partnerships and S corporations, see § 1.702-1(a)(8)(ii) and section 1366(a)(1)(A), respectively. Credits that must be accounted for separately include (but are not limited to)—

(A) Credits (other than the low-income housing and rehabilitation investment credits) from a rental real estate activity (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T) that arise in a taxable year in which the taxpayer actively participates (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T) in such activity;

(B) Credits (other than the low-income housing and rehabilitation investment credits) from a rental real estate activity (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T) that arise in a taxable year in which the taxpayer does not actively participate (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T) in such activity;

(C) Low-income housing and rehabilitation investment credits from a rental real estate activity (within the meaning of section 469(i) and the rules to be contained in § 1.469-9T); and

(D) Any credit that is subject to the limitations of sections 26(a), 28(d)(2), 29(b)(5), or 38(c) in a manner that differs from the manner in which any other credit is subject to such limitations.

(4) *Carryover of disallowed deductions and credits.* [Reserved]. See § 1.469-1(f)(4) for rules relating to this paragraph.

(g) *Application of these rules to C corporations—(1) In general.* Except as otherwise provided in the rules to be contained in paragraph (k) of this section, section 469 and the regulations thereunder do not apply to any corporation that is not a personal service corporation or a closely held corporation for the taxable year. See paragraphs (g) (4) and (5) of this section for special rules for computing the passive activity loss and passive activity credit, respectively, of a closely held corporation.

(2) *Definitions.* For purposes of section 469 and the regulations thereunder—

(i) The term *personal service corporation* means a C corporation that is a personal service corporation for the taxable year (within the meaning of § 1.441-3(c)); and

(ii) The term *closely held corporation* means a C corporation that meets the stock ownership requirements of section 542(a)(2) (taking into account the modifications in section 465(a)(3)) for the taxable year and is not a personal service corporation for such year.

(3) *Participation of corporations—(i) Material participation.* For purposes of section 469 and the regulations thereunder, a corporation described in paragraph (g)(2) of this section shall be treated as materially participating in an activity for a taxable year if and only if—

(A) One or more individuals, each of whom is treated under paragraph (g)(3)(iii) of this section as materially participating in such activity for the taxable year, directly or indirectly hold (in the aggregate) more than 50 percent (by value) of the outstanding stock of such corporation; or

(B) In the case of a closely held corporation (within the meaning of paragraph (g)(2)(ii) of this section), the requirements of section 465(c)(7)(C) (without regard to clause (iv) thereof and taking into account section 465(c)(7)(D)) are met with respect to such activity.

(ii) *Significant participation.* For purposes of § 1.469-2T(f)(2), an activity of a corporation described in paragraph (g)(2) of this section shall be treated as a significant participation passive activity for a taxable year if and only if—

(A) The corporation is not treated as materially participating in such activity for the taxable year; and

(B) One or more individuals, each of whom is treated under paragraph (g)(3)(iii) of this section as significantly participating in such activity, directly or indirectly hold (in the aggregate) more than 50 percent (by value) of the outstanding stock of such corporation.

(iii) *Participation of individual.* Whether an individual is treated for purposes of this paragraph (g)(3) as materially participating or significantly participating in an activity of a corporation shall be determined under the rules of § 1.469-5T, except that in applying such rules—

(A) All activities of the corporation shall be treated as activities in which the individual holds an interest in determining whether the individual participates (within the meaning of § 1.469-5T(f)) in an activity of the corporation; and

(B) The individual's participation in all activities other than activities of the corporation shall be disregarded in determining whether the individual's participation in an activity of the corporation is treated as material participation under § 1.469-5T(a)(4) (relating to material participation in significant participation activities).

(4) *Modified computation of passive activity loss in the case of closely held corporations—(i) In general.* A closely held corporation's passive activity loss for the taxable year is the amount, if any, by which the corporation's passive activity deductions for the taxable year (within the meaning of § 1.469-2T(d)) exceed the sum of—

Internal Revenue Service, Treasury

§ 1.469-1T

(A) The corporation's passive activity gross income for the taxable year (within the meaning of §1.469-2T(c)); and

(B) The corporation's net active income for the taxable year.

(ii) *Net active income.* For purposes of this paragraph (g)(4), a corporation's net active income for the taxable year is such corporation's taxable income for the taxable year, determined without regard to the following items for the year:

(A) Passive activity gross income;

(B) Passive activity deductions;

(C) [Reserved]. See §1.469-1(g)(4)(ii)(C) for rules relating to this paragraph.

(D) Gross income that is treated under §1.469-2T(c)(6) (relating to gross income from certain oil or gas properties) as not from a passive activity;

(E) Gross income and deductions from any trade or business activity (within the meaning of paragraph (e)(2) of this section) that is described in paragraph (e)(6) of this section (relating to certain activities of trading personal property) but only if the corporation did not materially participate in such activity for the taxable year;

(F) Deductions described in §1.469-2T(d)(2)(i), (ii), and (iv) (relating to cer-

tain deductions attributable to portfolio income); and

(G) Interest expense allocated under §1.163-8T to a portfolio expenditure (within the meaning of §1.163-8T(b)(6)).

(iii) *Examples.* The following examples illustrate the application of this paragraph (g)(4):

Example 1. (i) For 1987, X, a closely held corporation, is engaged in two activities, a trade or business activity in which X materially participates for 1987 and a rental activity. X also holds portfolio investments. For 1987, X has the following gross income and deductions:

Gross income:		
Rents	\$60,000	
Gross income from business	100,000	
Portfolio income	35,000	
		\$195,000
Deductions:		
Rental deductions	(\$100,000)	
Business deductions (80,000)		
Interest expense allocable to portfolio expenditures under § 1.163-8T	(10,000)	
Deductions (other than interest expense) clearly and directly allocable to portfolio income	(5,000)	
		(\$195,000)

(ii) The corporation's net active income for 1987 is \$20,000, computed as follows:

Gross income		\$195,000	
Amounts not taken into account in computing net active income:			
Rents (see paragraph (g)(4)(ii)(A) of this section)	\$60,000		
Portfolio income (see paragraph (g)(4)(ii)(C) of this section)	\$35,000		
		\$95,000	(\$95,000)
Gross income taken into account in computing net active income		\$100,000	\$100,000
Deductions			
Amounts not taken into account in computing net active income:			
Rental deductions (see paragraph (g)(4)(ii)(B) of this section)	(\$100,000)		
Interest expense allocated to portfolio expenditures (see paragraph (g)(4)(ii)(G) of this section)	(\$10,000)		
Other deductions clearly and directly allocable to portfolio income (see paragraph (g)(4)(ii)(F) of this section)	(\$5,000)		
		(\$115,000)	\$115,000
Deductions taken into account in computing net active income		(\$80,000)	(\$80,000)
Net active income			\$20,000

(iii) Under paragraph (g)(4)(i) of this section, X's passive activity loss for 1987 is \$20,000, the amount by which the passive activity deductions for the taxable year (\$100,000) exceed the sum of (a) the passive activity gross income for the taxable year (\$60,000) and (b) the net active income for the taxable year (\$20,000). Under paragraph (f)(4)

of this section, the \$20,000 of deductions from X's rental activity that are disallowed for 1987 are treated as deductions from the rental activity for 1988. If computed without regard to the net active income for the taxable year, X's passive activity loss would be \$40,000 (\$100,000 of rental deductions minus \$60,000 of rental income). Thus, the effect of

the rule in paragraph (g)(4)(i) of this section is to reduce the corporation's passive activity loss for the taxable year by the amount of the corporation's net active income for such year.

(iv) Under these facts, X's taxable income for 1987 is \$20,000, computed as follows:

Gross income		\$195,000	
Deductions:			
Total deductions	(\$195,000)		
Passive activity loss	\$20,000		
Allowable deductions	(\$175,000)	(\$175,000)	
Taxable income			\$20,000

Example 2. (i) The facts are the same as in Example 1, except that, in 1988, X has a loss from the trade or business activity, and a net operating loss ("NOL") of \$15,000 that is carried back under section 172(b) to 1987. Since NOL carrybacks are taken into account in computing net active income, X's net active income for 1987 must be recomputed as follows:

Net active income before NOL carryback	\$20,000	
NOL carryback		(\$15,000)
Net active income		\$5,000

(ii) Under these facts, X's disallowed passive activity loss for 1987 is \$35,000, the amount by which the passive activity deductions for the taxable year (\$100,000) exceed the sum of (a) the passive activity gross income for the taxable year (\$60,000) and (b) the net active income for the taxable year (\$5,000).

(iii) Under paragraph (f)(4) of this section, the \$35,000 of deductions from X's rental activity that are disallowed for 1987 are treated as deductions from the rental activity for 1988. X's taxable income for 1987 is \$20,000, computed as follows:

Gross income		\$195,000	
Deductions:			
Total deductions	(\$210,000)		
Passive activity loss	\$35,000		
Allowable deductions	(\$175,000)	(\$175,000)	
Taxable income			\$20,000

Thus, taking the NOL carryback into account in computing net active income for 1987 does not affect X's taxable income for 1987, but increases the deductions treated under paragraph (f)(4) as deductions from X's rental activity for 1988 and decreases X's NOL carryover to years other than 1987.

(5) *Allowance of passive activity credit of closely held corporations to extent of net active income tax liability*—(i) *In general.* Solely for purposes of determining the amount disallowed under paragraph (a)(1)(ii) of this section, a closely held corporation's passive activity

credit for the taxable year shall be reduced by such corporation's net active income tax liability for such year.

(ii) *Net active income tax liability.* For purposes of paragraph (g)(5)(i) of this section, a corporation's net active income tax liability for a taxable year is the amount (if any) by which—

(A) The corporation's regular tax liability (within the meaning of section 26(b)) for the taxable year, determined by reducing the corporation's taxable income for such year by an amount equal to the excess (if any) of the corporation's passive activity gross income for such year over the corporation's passive activity deductions for such year; exceeds

(B) The sum of—

(1) The corporation's regular tax liability for the taxable year, determined by reducing the corporation's taxable income for such year by an amount equal to the excess (if any) of the sum of the corporation's net active income (within the meaning of paragraph (g)(4)(ii) of this section) and passive activity gross income for such year over the corporation's passive activity deductions for such year; and

(2) The corporation's credits (other than credits from passive activities) that are allowable for the taxable year (without regard to the limitations contained in sections 26(a), 28(d)(2), 29(b)(5), 38(c), and 469).

(h) *Special rules for affiliated group filing consolidated return.* (1)–(2) [Reserved]

(3) *Disallowance of consolidated group's passive activity loss or credit.* A consolidated group's passive activity loss or passive activity credit for the taxable year shall be disallowed to the extent provided in paragraph (a) of this section. For purposes of the preceding sentence, a consolidated group's passive activity loss and passive activity credit shall be determined by taking into account the following items of each member of such group:

- (i) Passive activity gross income;
- (ii) Passive activity deductions;
- (iii) Net active income (in the case of a consolidated group treated as a closely held corporation under paragraph (h)(4)(ii) of this section); and
- (iv) Credits from passive activities.

(4) [Reserved]. See § 1.469-1(h)(4) for rules relating to this paragraph.

(5) *Modification of rules for identifying disallowed passive activity deductions and credits*—(i) *Identification of disallowed deductions.* In applying paragraphs (f)(2) and (4) of this section to a consolidated group for purposes of identifying the passive activity deductions of such consolidated group and of each member of such consolidated group that are disallowed for the taxable year and treated as deductions from activities for the succeeding taxable year, the following rules shall apply:

(A) A ratable portion (within the meaning of paragraph (h)(5)(ii) of this section) of the passive activity loss of the consolidated group that is disallowed for the taxable year shall be allocated to each member of the group;

(B) Paragraph (f)(2) of this section shall then be applied to each member of the group as if—

(1) Such member were a separate taxpayer; and

(2) The amount allocated to such member under paragraph (h)(5)(i)(A) of this section were the amount of such member's passive activity loss that is disallowed for the taxable year; and

(C) Paragraph (f)(4) of this section shall be applied to each member of the group as if it were a separate taxpayer.

(ii) *Ratable portion of disallowed passive activity loss.* For purposes of paragraph (h)(5)(i)(A) of this section, a member's ratable portion of the disallowed passive activity loss of the consolidated group is the amount of such disallowed loss multiplied by the fraction obtained by dividing—

(A) The amount of the passive activity loss of such member of the consolidated group that would be disallowed for the taxable year if the items of gross income and deduction of such member were the only items of the group for such year; by

(B) The sum of the amounts described in paragraph (h)(5)(i)(A) of this section for all members of the group.

(iii) *Identification of disallowed credits.* In applying paragraph (f)(3) of this section to a consolidated group for purposes of identifying the credits from passive activities of members of such consolidated group that are disallowed for the taxable year, the consolidated

group shall be treated as one taxpayer. Thus, a ratable portion of each of the group's credits from passive activities is disallowed.

(6) [Reserved]

(7) *Disposition of stock of a member of an affiliated group.* Any gain recognized by a member on the disposition of stock of a subsidiary (including income resulting from the recognition of an excess loss account under § 1.1502-19) shall be treated as portfolio income (within the meaning of § 1.469-2T(c)(3)(i)).

(8) *Dispositions of property used in multiple activities.* The determination of whether § 1.469-2T(c)(2)(ii) or (iii) or (d)(5)(ii) applies to a disposition (including a deemed disposition described in paragraph (h)(6)(iii)(C)(I) of this section) of property by a member of a consolidated group shall be made by treating such member as having held the property for the entire period that the group has owned such property and as having used the property in all of the activities in which the group has used such property

(i) [Reserved]

(j) *Spouses filing joint return*—(1) *In general.* Except as otherwise provided in the regulations under section 469, spouses filing a joint return for a taxable year shall be treated for such year as one taxpayer for purposes of section 469 and the regulations thereunder. Thus, for example, spouses filing a joint return are treated as one taxpayer for purposes of—

(i) Section 1.469-2T (relating generally to the computation of such taxpayer's passive activity loss); and

(ii) Paragraph (f) of this section (relating to the allocation of such taxpayer's disallowed passive activity loss and passive activity credit among activities and the identification of disallowed passive activity deductions and credits from passive activities).

(2) *Exceptions to treatment as one taxpayer*—(i) *Identification of disallowed deductions and credits.* For purposes of paragraphs (f)(2)(iii) and (3)(iii) of this section, spouses filing a joint return for the taxable year must account separately for the deductions and credits attributable to the interests of each spouse in any activity.

(ii) *Treatment of deductions disallowed under sections 704(d), 1366(d), and 465.*

§ 1.469-2

26 CFR Ch. I (4-1-16 Edition)

Notwithstanding any other provision of this section or § 1.469-2T, this paragraph (j) shall not affect the application of section 704(d), section 1366(d), or section 465 to taxpayers filing a joint return for the taxable year.

(iii) *Treatment of losses from working interests.* Paragraph (e)(4) of this section (relating to losses and credits from certain interests in oil and gas wells) shall be applied by treating a husband and wife (whether or not filing a joint return) as separate taxpayers.

(3) *Joint return no longer filed.* If an individual—

(A) Does not file a joint return for the taxable years; and

(B) Filed a joint return for the immediately preceding taxable year;

then the passive activity deductions and credits allocable to such individual's activities for the taxable year under paragraph (f)(4) of this section shall be determined by taking into account the items of deduction and credit attributable to such individual's interests in passive activities for the immediately preceding taxable year. See paragraph (j)(2)(i) of this section.

(4) *Participation of spouses.* Rules treating an individual's participation in an activity as participation of such individual's spouse in such activity (without regard to whether the spouses file a joint return) are contained in § 1.469-5T(f)(3).

(k) *Former passive activities and changes in status of corporations.* [Reserved]

[T.D. 8175, 53 FR 5700, Feb. 25, 1988, as amended by T.D. 8253, 54 FR 20535, May 12, 1989; T.D. 8319, 55 FR 49038, Nov. 26, 1990; T.D. 8417, 57 FR 20753, May 15, 1992; 58 FR 29536, May 21, 1993; 58 FR 45059, Aug. 26, 1993; 59 FR 17478, Apr. 13, 1994; T.D. 8560, 59 FR 41674, Aug. 15, 1994; T.D. 8597, 60 FR 36685, July 18, 1995; T.D. 8996, 67 FR 35012, May 17, 2002]

§ 1.469-2 Passive activity loss.

(a)-(c)(2)(ii) [Reserved]

(c)(2)(iii) *Disposition of substantially appreciated property formerly used in nonpassive activity—(A) In general.* If an interest in property used in an activity is substantially appreciated at the time of its disposition, any gain from the disposition shall be treated as not from a passive activity unless the in-

terest in property was used in a passive activity for either—

(1) 20 percent of the period during which the taxpayer held the interest in property; or

(2) The entire 24-month period ending on the date of the disposition.

(B) *Date of disposition.* For purposes of this paragraph (c)(2)(iii), a disposition of an interest in property is deemed to occur on the date that the interest in property becomes subject to an oral or written agreement that either requires the owner or gives the owner an option to transfer the interest in property for consideration that is fixed or otherwise determinable on that date.

(C) *Substantially appreciated property.* For purposes of this paragraph (c)(2)(iii), an interest in property is substantially appreciated if the fair market value of the interest in property exceeds 120 percent of the adjusted basis of the interest.

(D) *Investment property.* For purposes of this paragraph (c)(2)(iii), an interest in property is treated as an interest in property used in an activity other than a passive activity and as an interest in property held for investment for any period during which the interest is held through a C corporation or similar entity. An entity is similar to a C corporation for this purpose if the owners of interests in the entity derive only portfolio income (within the meaning of § 1.469-2T) from the interests.

(E) *Coordination with § 1.469-2T(c)(2)(ii).* If § 1.469-2T(c)(2)(ii) applies to the disposition of an interest in property, this paragraph (c)(2)(iii) applies only to that portion of the gain from the disposition of the interest in property that is characterized as gain from a passive activity after the application of § 1.469-2T(c)(2)(ii).

(F) *Coordination with section 163(d).* Gain that is treated as not from a passive activity under this paragraph (c)(2)(iii) is treated as income described in section 469(e)(1)(A) and § 1.469-2T(c)(3)(i) if and only if the gain is from the disposition of an interest in property that was held for investment for more than 50 percent of the period during which the taxpayer held that interest in property in activities other than passive activities.