Department of the Treasury

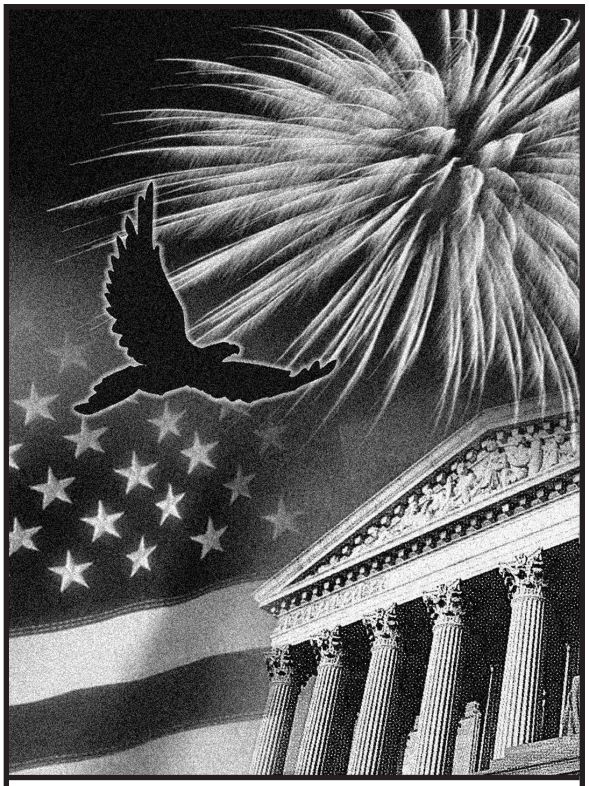
Internal Revenue Service

Publication 925
Cat. No. 64265X

Passive Activity and At-Risk Rules

For use in preparing

2015 Returns



Get forms and other information faster and easier at:

- *IRS.gov* (English)
- *IRS.gov/Spanish* (Español)
- *IRS.gov/Chinese* ( )
- *IRS.gov/Korean* (한국어)
- *IRS.gov/Russian* (Русский)
- *IRS.gov/Vietnamese* (TiếngViệt)

Contents

Future Developments 1

Reminders 1

Introduction 2

Passive Activity Limits 2
- Who Must Use These Rules? 2
- Passive Activities 3
- Activities That Are Not Passive Activities 5
- Passive Activity Income and Deductions 6
- Grouping Your Activities 8
- Recharacterization of Passive Income 10
- Dispositions 12
- How To Report Your Passive Activity Loss 12

At-Risk Limits 12
- Who Is Affected? 13
- Activities Covered by the At-Risk Rules 13
- At-Risk Amounts 14
- Amounts Not At Risk 15
- Reductions of Amounts At Risk 15
- Recapture Rule 15

How To Get Tax Help 16

Index 17

Future Developments

For the latest developments related to Publication 925, such as legislation enacted after it was published, go to *www.irs.gov/pub925*.

Reminders

Regrouping Due to Net Investment Income Tax. You may be able to regroup your activities if you are subject to the Net Investment Income Tax. See *Regrouping Due to Net Investment Income Tax* under *Grouping Your Activities*, later, for more information.

At-risk amounts. The following rules apply to amounts borrowed after May 3, 2004.

- You must file Form 6198, At-Risk Limitations, if you are engaged in an activity included in (6) under *Activities Covered by the At-Risk Rules* and you have borrowed certain amounts described in *Certain borrowed amounts excluded* under *At-Risk Amounts* in this publication.
- You may be considered at risk for certain amounts described in *Certain borrowed amounts excluded* under *At-Risk Amounts* secured by real property used in the activity of holding real property (other than mineral property) that, if nonrecourse, would be qualified nonrecourse financing.

Photographs of missing children. The Internal Revenue Service is a proud partner with the

National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

This publication discusses two sets of rules that may limit the amount of your deductible loss from a trade, business, rental, or other income-producing activity. The first part of the publication discusses the passive activity rules. The second part discusses the at-risk rules. However, when you figure your allowable losses from any activity, you must apply the at-risk rules before the passive activity rules.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can send us comments from www.irs.gov/formspubs. Click on "More Information" and then on "Give us feedback."

Or you can write to:

Internal Revenue Service
Tax Forms and Publications
1111 Constitution Ave. NW, IR-6526
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Although we cannot respond individually to each comment received, we do appreciate your feedback and will consider your comments as we revise our tax products.

Ordering forms and publications. Visit www.irs.gov/formspubs to download forms and publications. Otherwise, you can go to www.irs.gov/orderforms to order current and prior-year forms and instructions. Your order should arrive within 10 business days.

Tax questions. If you have a tax question not answered by this publication, check IRS.gov and How To Get Tax Help at the end of this publication.

Useful Items

You may want to see:

Publication

- ❑ **527** Residential Rental Property (Including Rental of Vacation Homes)
- ❑ **541** Partnerships

Form (and Instructions)

- ❑ **4952** Investment Interest Expense Deduction
- ❑ **6198** At-Risk Limitations
- ❑ **8582** Passive Activity Loss Limitations
- ❑ **8582-CR** Passive Activity Credit Limitations
- ❑ **8810** Corporate Passive Activity Loss and Credit Limitations
- ❑ **8949** Sales and Other Dispositions of Capital Assets

See *How To Get Tax Help* near the end of this publication for information about getting these publications and forms.

Passive Activity Limits

Who Must Use These Rules?

The passive activity rules apply to:

- Individuals,
- Estates,
- Trusts (other than grantor trusts),
- Personal service corporations, and
- Closely held corporations.

Even though the rules do not apply to grantor trusts, partnerships, and S corporations directly, they do apply to the owners of these entities.

For information about personal service corporations and closely held corporations, including definitions and how the passive activity rules apply to these corporations, see Form 8810 and its instructions.

CAUTION *Before applying the passive activity limits, you must first determine the amount of the deductions disallowed under the basis, excess farm loss, or at-risk rules. See* Passive Activity Deductions*, later.*

Passive Activity Loss

Generally, the passive activity loss for the tax year is not allowed. However, there is a special allowance under which some or all of your passive activity loss may be allowed. See *Special $25,000 allowance*, later.

Definition of passive activity loss. Generally, your passive activity loss for the tax year is the excess of your passive activity deductions over your passive activity gross income. See *Passive Activity Income and Deductions*, later.

For a closely held corporation, the passive activity loss is the excess of passive activity deductions over the sum of passive activity gross income and net active income. For details on net active income, see the Instructions for Form 8810. For the definition of passive activity gross income, see *Passive Activity Income*, later. For the definition of passive activity deductions, see *Passive Activity Deductions*, later.

Identification of Disallowed Passive Activity Deductions

If all or a part of your passive activity loss is disallowed for the tax year, you may need to allocate the disallowed passive activity loss among different passive activities and among different deductions within a passive activity.

Allocation of disallowed passive activity loss among activities. If all or any part of your passive activity loss is disallowed for the tax year, a ratable portion of the loss (if any) from each of your passive activities is disallowed. The ratable portion of a loss from an activity is computed by multiplying the passive activity loss that is disallowed for the tax year by the fraction obtained by dividing:

1. The loss from the activity for the tax year; by
2. The sum of the losses for the tax year from all activities having losses for the tax year.

Use Worksheet 5 of Form 8582 to figure the ratable portion of the loss from each activity that is disallowed.

Loss from an activity. The term "loss from an activity" means:

1. The amount by which the passive activity deductions (defined later) from the activity for the tax year exceed the passive activity gross income (defined later) from the activity for the tax year; reduced by
2. Any part of such amount that is allowed under the *Special $25,000 Allowance*, later.

If your passive activity gross income from significant participation passive activities (defined later) for the tax year is more than your passive activity deductions from those activities for the tax year, those activities shall be treated, solely for purposes of figuring your loss from the activity, as a single activity that does not have a loss for such taxable year. See *Significant Participation Passive Activities*, later.

Example. John Pine 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)

John Pine's $21,000 passive activity loss for the taxable year is disallowed. Therefore, a ratable portion of the losses from activities A and B is disallowed. He figures the disallowed portion of each loss as follows:

A: $21,000 x $9,000/$25,000	$7,560
B: $21,000 x $16,000/$25,000	13,440
Total	$21,000

Allocation within loss activities. If all or any part of your loss from an activity is disallowed under *Allocation of disallowed passive activity loss among activities* for the tax year, a ratable portion of each of your passive activity deductions (defined later), other than an excluded deduction (defined below) from such activity is

disallowed. The ratable portion of a passive activity deduction is the amount of the disallowed portion of the loss from the activity for the tax year multiplied by the fraction obtained by dividing:

1. The amount of such deduction; by
2. The sum of all of your passive activity deductions (other than excluded deductions) from that activity from the tax year.

Excluded deductions. "Excluded deduction" means any passive activity deduction that is taken into account in computing your 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. See *Recharacterization of Passive Income*, later.

Separately identified deductions. In identifying the deductions from an activity that are disallowed, you do not need to account separately for a deduction unless such deduction may, if separately taken into account, result in an income tax liability for any tax year different from that which would result were such deduction not taken into account separately.

Use Form 8582, Worksheet 7, for any activity if you have passive activity deductions for that activity that must be separately identified.

Deductions that must be accounted for separately include (but are not limited to) the following deductions.

- Deductions that arise in a rental real estate activity in tax years in which you actively participate in such activity. See *Active participation*, later.
- Deductions that arise in a rental real estate activity in tax years in which you do not actively participate in such activity. See *Active participation*, later.
- Losses from sales or exchanges of capital assets.
- Section 1231 losses. See *Section 1231 Gains and Losses* in Publication 544, Sales and Other Disposition of Assets, for more information.

Carryover of Disallowed Deductions

In the case of an activity with respect to which any deductions or credits are disallowed for a taxable year (the loss activity), the disallowed deductions are allocated among your activities for the next tax year in a manner that reasonably reflects the extent to which each activity continues the loss activity. The disallowed deductions or credits allocated to an activity under the preceding sentence are treated as deductions or credits from the activity for the next tax year. For more information, see Regulations section 1.469-1(f)(4).

Passive Activity Credit

Generally, the passive activity credit for the tax year is disallowed.

The passive activity credit is the amount by which the sum of all your credits subject to the passive activity rules exceed your regular tax liability allocable to all passive activities for the tax year. Credits that are included in figuring the general business credit are subject to the passive activity rules.

See the Instructions for Form 8582-CR for more information.

Publicly Traded Partnership

You must apply the rules in this part separately to your income or loss from a passive activity held through a publicly traded partnership (PTP). You also must apply the limit on passive activity credits separately to your credits from a passive activity held through a PTP.

You can offset deductions from passive activities of a PTP only against income or gain from passive activities of the same PTP. Likewise, you can offset credits from passive activities of a PTP only against the tax on the net passive income from the same PTP. This separate treatment rule also applies to a regulated investment company holding an interest in a PTP for the items attributable to that interest.

For more information on how to apply the passive activity loss rules to PTPs, and on how to apply the limit on passive activity credits to PTPs, see *Publicly Traded Partnerships (PTPs)* in the Instructions for Forms 8582 and 8582-CR, respectively.

Excess Farm Loss

If you have an excess farm loss for the tax year, special rules may apply. These rules do not apply to C corporations. For information on excess farm losses, see the Instructions for Schedule F (Form 1040), Profit or Loss From Farming.

Passive Activities

There are two kinds of passive activities.

- Trade or business activities in which you do not materially participate during the year.
- Rental activities, even if you do materially participate in them, unless you are a real estate professional.

Material participation in a trade or business is discussed later, under *Activities That Are Not Passive Activities*.

Treatment of former passive activities. A former passive activity is an activity that was a passive activity in any earlier tax year, but is not a passive activity in the current tax year. You can deduct a prior year's unallowed loss from the activity up to the amount of your current year net income from the activity. Treat any remaining prior year unallowed loss like you treat any other passive loss.

In addition, any prior year unallowed passive activity credits from a former passive activity offset the allocable part of your current year tax liability. The allocable part of your current year tax liability is that part of this year's tax liability that is allocable to the current year net income from the former passive activity. You figure this after you reduce your net income from the activity by any prior year unallowed loss from that activity (but not below zero).

Trade or Business Activities

A trade or business activity is an activity that:

- Involves the conduct of a trade or business (that is, deductions would be allowable under section 162 of the Internal Revenue Code if other limitations, such as the passive activity rules, did not apply),
- Is conducted in anticipation of starting a trade or business, or
- Involves research or experimental expenditures that are deductible under Internal Revenue Code section 174 (or that would be deductible if you chose to deduct rather than capitalize them).

A trade or business activity does not include a rental activity or the rental of property that is incidental to an activity of holding the property for investment.

You generally report trade or business activities on Schedule C, C-EZ, F, or in Part II or III of Schedule E.

Rental Activities

A rental activity is a passive activity even if you materially participated in that activity, unless you materially participated as a real estate professional. See *Real Estate Professional* under *Activities That Are Not Passive Activities*, later. An activity is a rental activity if tangible property (real or personal) is used by customers or held for use by customers, and the gross income (or expected gross income) from the activity represents amounts paid (or to be paid) mainly for the use of the property. It does not matter whether the use is under a lease, a service contract, or some other arrangement.

Exceptions. Your activity is not a rental activity if any of the following apply.

1. The average period of customer use of the property is 7 days or less. You figure the average period of customer use by dividing the total number of days in all rental periods by the number of rentals during the tax year. If the activity involves renting more than one class of property, multiply the average period of customer use of each class by a fraction. The numerator of the fraction is the gross rental income from that class of property and the denominator is the activity's total gross rental income. The activity's average period of customer use will equal the sum of the amounts for each class.
2. The average period of customer use of the property, as figured in (1) above, is 30 days or less and you provide significant personal services with the rentals. Significant personal services include only services performed by individuals. To determine if personal services are significant, all relevant facts and circumstances are taken into consideration, including the frequency of the services, the type and amount of labor required to perform the services, and the value of the services relative to the amount charged for use of the property. Significant personal services do not include the following.

a. Services needed to permit the lawful use of the property,

b. Services to repair or improve property that would extend its useful life for a period substantially longer than the average rental, and

c. Services that are similar to those commonly provided with long-term rentals of real estate, such as cleaning and maintenance of common areas or routine repairs.

3. You provide extraordinary personal services in making the rental property available for customer use. Services are extraordinary personal services if they are performed by individuals and the customers' use of the property is incidental to their receipt of the services.

4. The rental is incidental to a nonrental activity. The rental of property is incidental to an activity of holding property for investment if the main purpose of holding the property is to realize a gain from its appreciation and the gross rental income from the property is less than 2% of the smaller of the property's unadjusted basis or fair market value. The unadjusted basis of property is its cost not reduced by depreciation or any other basis adjustment. The rental of property is incidental to a trade or business activity if all of the following apply.

   a. You own an interest in the trade or business activity during the year.

   b. The rental property was used mainly in that trade or business activity during the current year, or during at least 2 of the 5 preceding tax years.

   c. Your gross rental income from the property is less than 2% of the smaller of its unadjusted basis or fair market value. Lodging provided to an employee or the employee's spouse or dependents is incidental to the activity or activities in which the employee performs services if the lodging is furnished for the employer's convenience.

5. You customarily make the rental property available during defined business hours for nonexclusive use by various customers.

6. You provide the property for use in a nonrental activity in your capacity as an owner of an interest in the partnership, S corporation, or joint venture conducting that activity.

TIP *If you meet any of the exceptions listed above, see the instructions for Form 8582 for information about how to report any income or loss from the activity.*

Special $25,000 allowance. If you or your spouse actively participated in a passive rental real estate activity, the amount of the passive activity loss that is disallowed is decreased and you therefore can deduct up to $25,000 of loss from the activity from your nonpassive income. This special allowance is an exception to the general rule disallowing the passive activity loss. Similarly, you can offset credits from the activity against the tax on up to $25,000 of nonpassive income after taking into account any losses allowed under this exception.

If you are married, filing a separate return, and lived apart from your spouse for the entire tax year, your special allowance cannot be more than $12,500. If you lived with your spouse at any time during the year and are filing a separate return, you cannot use the special allowance to reduce your nonpassive income or tax on nonpassive income.

The maximum special allowance is reduced if your modified adjusted gross income exceeds certain amounts. See *Phaseout rule*, later.

Example. Kate, a single taxpayer, has $70,000 in wages, $15,000 income from a limited partnership, a $26,000 loss from rental real estate activities in which she actively participated, and is not subject to the modified adjusted gross income phaseout rule. She can use $15,000 of her $26,000 loss to offset her $15,000 passive income from the partnership. She actively participated in her rental real estate activities, so she can use the remaining $11,000 rental real estate loss to offset $11,000 of her nonpassive income (wages).

Commercial revitalization deduction (CRD). The special allowance must first be applied to losses from rental real estate activities figured without the CRD. Any remaining part of the special allowance is available for the CRD from the rental real estate activities and is not subject to the active participation rules or the phaseout based on modified adjusted gross income.

CAUTION *You cannot claim a CRD for a building placed in service after December 31, 2009.*

Active participation. Active participation is not the same as material participation (defined later). Active participation is a less stringent standard than material participation. For example, you may be treated as actively participating if you make management decisions in a significant and bona fide sense. Management decisions that count as active participation include approving new tenants, deciding on rental terms, approving expenditures, and similar decisions.

Only individuals can actively participate in rental real estate activities. However, a decedent's estate is treated as actively participating for its tax years ending less than 2 years after the decedent's death, if the decedent would have satisfied the active participation requirement for the activity for the tax year the decedent died.

A decedent's qualified revocable trust can also be treated as actively participating if both the trustee and the executor (if any) of the estate choose to treat the trust as part of the estate. The choice applies to tax years ending after the decedent's death and before:

- 2 years after the decedent's death if no estate tax return is required, or
- 6 months after the estate tax liability is finally determined if an estate tax return is required.

The choice is irrevocable and cannot be made later than the due date for the estate's first income tax return (including any extensions).

Limited partners are not treated as actively participating in a partnership's rental real estate activities.

You are not treated as actively participating in a rental real estate activity unless your interest in the activity (including your spouse's interest) was at least 10% (by value) of all interests in the activity throughout the year.

Active participation is not required to take the low-income housing credit, the rehabilitation investment credit, or CRD from rental real estate activities.

Example. Mike, a single taxpayer, had the following income and loss during the tax year:

Salary	$42,300
Dividends	300
Interest	1,400
Rental loss	(4,000)

The rental loss came from a house Mike owned. He advertised and rented the house to the current tenant himself. He also collected the rents and did the repairs or hired someone to do them.

Even though the rental loss is a loss from a passive activity, Mike can use the entire $4,000 loss to offset his other income because he actively participated.

Phaseout rule. The maximum special allowance of $25,000 ($12,500 for married individuals filing separate returns and living apart at all times during the year) is reduced by 50% of the amount of your modified adjusted gross income that is more than $100,000 ($50,000 if you are married filing separately). If your modified adjusted gross income is $150,000 or more ($75,000 or more if you are married filing separately), you generally cannot use the special allowance.

Modified adjusted gross income for this purpose is your adjusted gross income figured without the following.

- Taxable social security and tier 1 railroad retirement benefits.
- Deductible contributions to individual retirement accounts (IRAs) and section 501(c)(18) pension plans.
- The exclusion from income of interest from qualified U.S. savings bonds used to pay qualified higher education expenses.
- The exclusion from income of amounts received from an employer's adoption assistance program.
- Passive activity income or loss included on Form 8582.
- Any rental real estate loss allowed because you materially participated in the rental activity as a *Real Estate Professional* (as discussed later, under *Activities That Are Not Passive Activities*).
- Any overall loss from a publicly traded partnership (see *Publicly Traded Partnerships (PTPs)* in the instructions for Form 8582).

- The deduction allowed for the deductible part of self-employment tax.
- The deduction for domestic production activities.
- The deduction allowed for interest on student loans.
- The deduction for qualified tuition and related expenses.

Example. During 2015, John was unmarried and was not a real estate professional. For 2015, he had $120,000 in salary and a $31,000 loss from his rental real estate activities in which he actively participated. His modified adjusted gross income is $120,000. When he files his 2015 return, he can deduct only $15,000 of his passive activity loss. He must carry over the remaining $16,000 passive activity loss to 2016. He figures his deduction and carryover as follows:

Adjusted gross income, modified as required	$120,000
Minus amount not subject to phaseout	100,000
Amount subject to phaseout rule	$20,000
Multiply by 50%	× 50%
Required reduction to special allowance	$10,000
Maximum special allowance	$25,000
Minus required reduction (see above)	10,000
Adjusted special allowance	$15,000
Passive loss from rental real estate	$31,000
Deduction allowable/Adjusted special allowance (see above)	15,000
Amount that must be carried forward	$16,000

Exceptions to the phaseout rules. A higher phaseout range applies to rehabilitation investment credits from rental real estate activities. For those credits, the phaseout of the $25,000 special allowance starts when your modified adjusted gross income exceeds $200,000 ($100,000 if you are a married individual filing a separate return and living apart at all times during the year).

There is no phaseout of the $25,000 special allowance for low-income housing credits or for the CRD.

Ordering rules. If you have more than one of the exceptions to the phaseout rules in the same tax year, you must apply the $25,000 phaseout against your passive activity losses and credits in the following order.

1. The portion of passive activity losses not attributable to the CRD.
2. The portion of passive activity losses attributable to the CRD.
3. The portion of passive activity credits attributable to credits other than the rehabilitation and low-income housing credits.
4. The portion of passive activity credits attributable to the rehabilitation credit.
5. The portion of passive activity credits attributable to the low-income housing credit.

Activities That Are Not Passive Activities

The following are not passive activities.

1. Trade or business activities in which you materially participated for the tax year.
2. A working interest in an oil or gas well which you hold directly or through an entity that does not limit your liability (such as a general partner interest in a partnership). It does not matter whether you materially participated in the activity for the tax year. However, if your liability was limited for part of the year (for example, you converted your general partner interest to a limited partner interest during the year) and you had a net loss from the well for the year, some of your income and deductions from the working interest may be treated as passive activity gross income and passive activity deductions.
   See Temporary Regulations section 1.469-1T(e)(4)(ii).
3. The rental of a dwelling unit that you also used for personal purposes during the year for more than the greater of 14 days or 10% of the number of days during the year that the home was rented at a fair rental.
4. An activity of trading personal property for the account of those who own interests in the activity. See Temporary Regulations section 1.469-1T(e)(6).
5. Rental real estate activities in which you materially participated as a real estate professional. See *Real Estate Professional*, later.

CAUTION *You should not enter income and losses from these activities on Form 8582. Instead, enter them on the forms or schedules you would normally use.*

Material Participation

A trade or business activity is not a passive activity if you materially participated in the activity.

Material participation tests. You materially participated in a trade or business activity for a tax year if you satisfy any of the following tests.

1. You participated in the activity for more than 500 hours.
2. Your participation was substantially all the participation in the activity of all individuals for the tax year, including the participation of individuals who did not own any interest in the activity.
3. You participated in the activity for more than 100 hours during the tax year, and you participated at least as much as any other individual (including individuals who did not own any interest in the activity) for the year.
4. The activity is a significant participation activity, and you participated in all significant participation activities for more than 500 hours. A significant participation activity is any trade or business activity in which you participated for more than 100 hours during the year and in which you did not materially participate under any of the material participation tests, other than this test. See *Significant Participation Passive Activities*, under *Recharacterization of Passive Income*, later.
5. You materially participated in the activity (other than by meeting this fifth test) for any 5 (whether or not consecutive) of the 10 immediately preceding tax years.
6. The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years. An activity is a personal service activity if it involves the performance of personal services in the fields of health (including veterinary services), law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor.
7. Based on all the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis during the year.

You did not materially participate in the activity under test (7) if you participated in the activity for 100 hours or less during the year. Your participation in managing the activity does not count in determining whether you materially participated under this test if:

- Any person other than you received compensation for managing the activity, or
- Any individual spent more hours during the tax year managing the activity than you did (regardless of whether the individual was compensated for the management services).

Participation. In general, any work you do in connection with an activity in which you own an interest is treated as participation in the activity.

Work not usually performed by owners. You do not treat the work you do in connection with an activity as participation in the activity if both of the following are true.

- The work is not work that is customarily done by the owner of that type of activity.
- One of your main reasons for doing the work is to avoid the disallowance of any loss or credit from the activity under the passive activity rules.

Participation as an investor. You do not treat the work you do in your capacity as an investor in an activity as participation unless you are directly involved in the day-to-day management or operations of the activity. Work you do as an investor includes:

- Studying and reviewing financial statements or reports on operations of the activity,

- Preparing or compiling summaries or analyses of the finances or operations of the activity for your own use, and
- Monitoring the finances or operations of the activity in a nonmanagerial capacity.

Spouse's participation. Your participation in an activity includes your spouse's participation. This applies even if your spouse did not own any interest in the activity and you and your spouse do not file a joint return for the year.

RECORDS **Proof of participation.** You can use any reasonable method to prove your participation in an activity for the year. You do not have to keep contemporaneous daily time reports, logs, or similar documents if you can establish your participation in some other way. For example, you can show the services you performed and the approximate number of hours spent by using an appointment book, calendar, or narrative summary.

Limited partners. If you owned an activity as a limited partner, you generally are not treated as materially participating in the activity. However, you are treated as materially participating in the activity if you met test (1), (5), or (6) under *Material participation tests*, discussed earlier, for the tax year.

You are not treated as a limited partner, however, if you also were a general partner in the partnership at all times during the partnership's tax year ending with or within your tax year (or, if shorter, during that part of the partnership's tax year in which you directly or indirectly owned your limited partner interest).

Retired or disabled farmer and surviving spouse of a farmer. If you are a retired or disabled farmer, you are treated as materially participating in a farming activity if you materially participated for 5 or more of the 8 years before your retirement or disability. Similarly, if you are a surviving spouse of a farmer, you are treated as materially participating in a farming activity if the real property used in the activity meets the estate tax rules for special valuation of farm property passed from a qualifying decedent, and you actively manage the farm.

Corporations. A closely held corporation or a personal service corporation is treated as materially participating in an activity only if one or more shareholders holding more than 50% by value of the outstanding stock of the corporation materially participate in the activity.

A closely held corporation can also satisfy the material participation standard by meeting the first two requirements for the qualifying business exception from the at-risk limits. See *Special exception for qualified corporations* under *Activities Covered by the At-Risk Rules*, later.

Real Estate Professional

Generally, rental activities are passive activities even if you materially participated in them. However, if you qualified as a real estate professional, rental real estate activities in which you materially participated are not passive activities. For this purpose, each interest you have in a rental real estate activity is a separate activity, unless you choose to treat all interests in rental real estate activities as one activity. See the Instructions for Schedule E (Form 1040), Supplemental Income and Loss, for information about making this choice.

If you qualified as a real estate professional for 2015, report income or losses from rental real estate activities in which you materially participated as nonpassive income or losses, and complete line 43 of Schedule E (Form 1040). If you also have an unallowed loss from these activities from an earlier year when you did not qualify, see *Treatment of former passive activities* under *Passive Activities*, earlier.

Qualifications. You qualified as a real estate professional for the year if you met both of the following requirements.

- More than half of the personal services you performed in all trades or businesses during the tax year were performed in real property trades or businesses in which you materially participated.
- You performed more than 750 hours of services during the tax year in real property trades or businesses in which you materially participated.

Do not count personal services you performed as an employee in real property trades or businesses unless you were a 5% owner of your employer. You were a 5% owner if you owned (or are considered to have owned) more than 5% of your employer's outstanding stock, outstanding voting stock, or capital or profits interest.

If you file a joint return, do not count your spouse's personal services to determine whether you met the preceding requirements. However, you can count your spouse's participation in an activity in determining if you materially participated.

Real property trades or businesses. A real property trade or business is a trade or business that does any of the following with real property.

- Develops or redevelops it.
- Constructs or reconstructs it.
- Acquires it.
- Converts it.
- Rents or leases it.
- Operates or manages it.
- Brokers it.

Closely held corporations. A closely held corporation can qualify as a real estate professional if more than 50% of the gross receipts for its tax year came from real property trades or businesses in which it materially participated.

Passive Activity Income and Deductions

In figuring your net income or loss from a passive activity, take into account only passive activity income and passive activity deductions.

Self-charged interest. Certain self-charged interest income or deductions may be treated as passive activity gross income or passive activity deductions if the loan proceeds are used in a passive activity.

Generally, self-charged interest income and deductions result from loans between you and a partnership or S corporation in which you had a direct or indirect ownership interest. This includes both loans you made to the partnership or S corporation and loans the partnership or S corporation made to you.

It also includes loans from one partnership or S corporation to another partnership or S corporation if each owner in the borrowing entity has the same proportional ownership interest in the lending entity.

Exception. The self-charged interest rules do not apply to your interest in a partnership or S corporation if the entity made an election under Regulations section 1.469-7(g) to avoid the application of these rules. For more details on the self-charged interest rules, see Regulations section 1.469-7.

Passive Activity Income

Passive activity income includes all income from passive activities and generally includes gain from disposition of an interest in a passive activity or property used in a passive activity.

Passive activity income does not include the following items.

- Income from an activity that is not a passive activity. These activities are discussed under *Activities That Are Not Passive Activities*, earlier.
- Portfolio income. This includes interest, dividends, annuities, and royalties not derived in the ordinary course of a trade or business. It includes gain or loss from the disposition of property that produces these types of income or that is held for investment. The exclusion for portfolio income does not apply to self-charged interest treated as passive activity income. For more information on self-charged interest, see *Self-charged interest*, earlier.
- Personal service income. This includes salaries, wages, commissions, self-employment income from trade or business activities in which you materially participated, deferred compensation, taxable social security and other retirement benefits, and payments from partnerships to partners for personal services.
- Income from positive section 481 adjustments allocated to activities other than passive activities. (Section 481 adjustments are adjustments that must be made due to changes in your accounting method.)
- Income or gain from investments of working capital.
- Income from an oil or gas property if you treated any loss from a working interest in the property for any tax year beginning after 1986 as a nonpassive loss, as discussed in item (2) under *Activities That Are Not Passive Activities*, earlier. This also applies to income from other oil and gas property the basis of which is determined wholly or partly by the basis of the property in the preceding sentence.

- Any income from intangible property, such as a patent, copyright, or literary, musical, or artistic composition, if your personal efforts significantly contributed to the creation of the property.
- Any other income that must be treated as nonpassive income. See *Recharacterization of Passive Income*, later.
- Overall gain from any interest in a publicly traded partnership. See *Publicly Traded Partnerships (PTPs)* in the instructions for Form 8582.
- State, local, and foreign income tax refunds.
- Income from a covenant not to compete.
- Reimbursement of a casualty or theft loss included in gross income to recover all or part of a prior year loss deduction, if the loss deduction was not a passive activity deduction.
- Alaska Permanent Fund dividends.
- Cancellation of debt income, if at the time the debt is discharged the debt is not allocated to passive activities under the interest expense allocation rules. See chapter 4 of Publication 535, Business Expenses, for information about the rules for allocating interest.

Disposition of property interests. Gain on the disposition of an interest in property generally is passive activity income if, at the time of the disposition, the property was used in an activity that was a passive activity in the year of disposition. The gain generally is not passive activity income if, at the time of disposition, the property was used in an activity that was not a passive activity in the year of disposition. An exception to this general rule may apply if you previously used the property in a different activity.

Exception for more than one use in the preceding 12 months. If you used the property in more than one activity during the 12-month period before its disposition, you must allocate the gain between the activities on a basis that reasonably reflects the property's use during that period. Any gain allocated to a passive activity is passive activity income.

For this purpose, an allocation of the gain solely to the activity in which the property was mainly used during that period reasonably reflects the property's use if the fair market value of your interest in the property is not more than the lesser of:

- $10,000, or
- 10% of the total of the fair market value of your interest in the property and the fair market value of all other property used in that activity immediately before the disposition.

Exception for substantially appreciated property. The gain is passive activity income if the fair market value of the property at disposition was more than 120% of its adjusted basis and either of the following conditions applies.

- You used the property in a passive activity for 20% of the time you held your interest in the property.
- You used the property in a passive activity for the entire 24-month period before its disposition.

If neither condition applies, the gain is not passive activity income. However, it is treated as portfolio income only if you held the property for investment for more than half of the time you held it in nonpassive activities.

For this purpose, treat property you held through a corporation (other than an S corporation) or other entity whose owners receive only portfolio income as property held in a nonpassive activity and as property held for investment. Also, treat the date you agree to transfer your interest for a fixed or determinable amount as the disposition date.

If you used the property in more than one activity during the 12-month period before its disposition, this exception applies only to the part of the gain allocated to a passive activity under the rules described in the preceding discussion.

Disposition of property converted to inventory. If you disposed of property that you had converted to inventory from its use in another activity (for example, you sold condominium units you previously held for use in a rental activity), a special rule may apply. Under this rule, you disregard the property's use as inventory and treat it as if it were still used in that other activity at the time of disposition. This rule applies only if you meet all of the following conditions.

- At the time of disposition, you held your interest in the property in a dealing activity (an activity that involves holding the property or similar property mainly for sale to customers in the ordinary course of a trade or business).
- Your other activities included a nondealing activity (an activity that does not involve holding similar property for sale to customers in the ordinary course of a trade or business) in which you used the property for more than 80% of the period you held it.
- You did not acquire or hold your interest in the property for the main purpose of selling it to customers in the ordinary course of a trade or business.

Passive Activity Deductions

Generally, a deduction is a passive activity deduction for a taxable year if and only if such deduction either:

1. Arises in connection with the conduct of an activity that is a passive activity for the tax year; or
2. Is treated as a deduction from an activity for the tax year because it was disallowed by the passive activity rules in the preceding year and carried forward to the tax year.

For purposes of item (1), above, an item of deduction arises in the taxable year in which the item would be allowable as a deduction under the taxpayer's method of accounting if taxable income for all taxable years were determined without regard to the passive activity rules and without regard to the basis, excess farm loss, and at-risk limits. See *Coordination with other limitations on deductions that apply before the passive activity rules*, later.

Passive activity deductions generally include any loss from a disposition of property used in a passive activity at the time of the disposition and any loss from a disposition of less than your entire interest in a passive activity.

Exceptions. Passive activity deductions do not include the following items.

- Deductions for expenses (other than interest expense) that are clearly and directly allocable to portfolio income.
- Qualified home mortgage interest, capitalized interest expenses, and other interest expenses (other than self-charged interest) properly allocable to passive activities. For more information on self-charged interest, see *Self-charged interest* under *Passive Activity Income and Deductions*, earlier.
- Losses from dispositions of property that produce portfolio income or property held for investment.
- State, local, and foreign income taxes.
- Miscellaneous itemized deductions that may be disallowed because of the 2%-of-adjusted-gross-income limit.
- Charitable contribution deductions.
- Net operating loss deductions.
- Percentage depletion carryovers for oil and gas wells.
- Capital loss carrybacks and carryovers.
- Items of deduction from a passive activity that are disallowed under the limits on deductions that apply before the passive activity rules. See *Coordination with other limitations on deductions that apply before the passive activity rules*, later.
- Deductions and losses that would have been allowed for tax years beginning before 1987 but for basis or at-risk limits.
- Net negative section 481 adjustments allocated to activities other than passive activities. (Section 481 adjustments are adjustments required due to changes in accounting methods.)
- Casualty and theft losses, unless losses similar in cause and severity recur regularly in the activity.
- The deduction allowed for the deductible part of self-employment tax.

Coordination with other limitations on deductions that apply before the passive activity rules. An item of deduction from a passive activity that is disallowed for a tax year under the basis or at-risk limitations is not a passive activity deduction for the tax year. The following sections provide rules for figuring the extent to which items of deduction from a passive activity are disallowed for a tax year under the basis or at-risk limitations.

Proration of deductions disallowed under basis limitations. If any amount of your distributive share of a partnership's loss for the tax year is disallowed under the basis limitation, a ratable portion of your distributive share of each item of deduction or loss of the partnership is disallowed for the tax year. For this purpose, the ratable portion of an item of deduction or loss is the amount of such item multiplied by the fraction obtained by dividing:

1. The amount of your distributive share of partnership loss that is disallowed for the taxable year; by
2. The sum of your distributive shares of all items of deduction and loss of the partnership for the tax year.

If any amount of your pro rata share of an S corporation's loss for the tax year is disallowed under the basis limitation, a ratable portion of your pro rata share of each item of deduction or loss of the S corporation is disallowed for the tax year. For this purpose, the ratable portion of an item of deduction or loss is the amount of such item multiplied by the fraction obtained by dividing:

1. The amount of your share of S corporation loss that is disallowed for the tax year; by
2. The sum of your pro rata shares of all items of deduction and loss of the corporation for the tax year.

Proration of deductions disallowed under at-risk limitation. If any amount of your loss from an activity (as defined in *Activities Covered by the At-Risk Rules*, later) is disallowed under the at-risk rules for the tax year, a ratable portion of each item of deduction or loss from the activity is disallowed for the tax year. For this purpose, the ratable portion of an item of deduction or loss is the amount of such item multiplied by the fraction obtained by dividing:

1. The amount of the loss from the activity that is disallowed for the tax year; by
2. The sum of all deductions from the activity for the taxable year.

Coordination of basis and at-risk limitations. The portion of any item of deduction or loss that is disallowed for the tax year under the basis limitations is not taken into account for the taxable year in determining the loss from an activity (as defined in *Activities Covered by the At-Risk Rules*, later) for purposes of applying the at-risk rules.

Separately identified items of deduction and loss. In identifying the items of deduction and loss from an activity that are not disallowed under the basis and at-risk limitations (and that therefore may be treated as passive activity deductions), you need not account separately for any item of deduction or loss unless such item may, if separately taken into account, result in an income tax liability different from that which would result were such item of deduction or loss taken into account separately.

Items of deduction or loss that must be accounted for separately include (but are not limited to) items of deduction or loss that:

1. Are attributable to separate activities. See *Grouping Your Activities*, later.
2. Arise in a rental real estate activity in tax years in which you actively participate in such activity;
3. Arise in a rental real estate activity in taxable years in which you do not actively participate in such activity;
4. Arose in a taxable year beginning before 1987 and were not allowed for such taxable year under the basis or at-risk limitations;
5. Are taken into account under section 613A(d) (relating to limitations on certain depletion deductions);
6. Are taken into account under section 1211 (relating to the limitation on capital losses);
7. Are taken into account under section 1231 (relating to property used in a trade or business and involuntary conversions). See *Section 1231 Gains and Losses* in Publication 544 for more information.
8. Are attributable to pre-enactment interests in activities. See Regulations section 1.469-11T(c).

Grouping Your Activities

You can treat one or more trade or business activities, or rental activities, as a single activity if those activities form an appropriate economic unit for measuring gain or loss under the passive activity rules.

Grouping is important for a number of reasons. If you group two activities into one larger activity, you need only show material participation in the activity as a whole. But if the two activities are separate, you must show material participation in each one. On the other hand, if you group two activities into one larger activity and you dispose of one of the two, then you have disposed of only part of your entire interest in the activity. But if the two activities are separate and you dispose of one of them, then you have disposed of your entire interest in that activity.

Grouping can also be important in determining whether you meet the 10% ownership requirement for actively participating in a rental real estate activity.

Appropriate Economic Units

Generally, to determine if activities form an appropriate economic unit, you must consider all the relevant facts and circumstances. You can use any reasonable method of applying the relevant facts and circumstances in grouping activities. The following factors have the greatest weight in determining whether activities form an appropriate economic unit. All of the factors do not have to apply to treat more than one activity as a single activity. The factors that you should consider are:

1. The similarities and differences in the types of trades or businesses,
2. The extent of common control,
3. The extent of common ownership,
4. The geographical location, and
5. The interdependencies between or among activities, which may include the extent to which the activities:
   a. Buy or sell goods between or among themselves,
   b. Involve products or services that are generally provided together,
   c. Have the same customers,
   d. Have the same employees, or
   e. Use a single set of books and records to account for the activities.

Example 1. John Jackson owns a bakery and a movie theater at a shopping mall in Baltimore and a bakery and movie theater in Philadelphia. Based on all the relevant facts and circumstances, there may be more than one reasonable method for grouping John's activities. For example, John may be able to group the movie theaters and the bakeries into:

- One activity,
- A movie theater activity and a bakery activity,
- A Baltimore activity and a Philadelphia activity, or
- Four separate activities.

Example 2. Betty is a partner in ABC partnership, which sells nonfood items to grocery stores. Betty is also a partner in DEF (a trucking business). ABC and DEF are under common control. The main part of DEF's business is transporting goods for ABC. DEF is the only trucking business in which Betty is involved. Based on the rules of this section, Betty treats ABC's wholesale activity and DEF's trucking activity as a single activity.

Consistency and disclosure requirement. Generally, when you group activities into appropriate economic units, you may not regroup those activities in a later tax year. You must meet any disclosure requirements of the IRS when you first group your activities and when you add or dispose of any activities in your groupings.

However, if the original grouping is clearly inappropriate or there is a material change in the facts and circumstances that makes the original grouping clearly inappropriate, you must regroup the activities and comply with any disclosure requirements of the IRS.

See *Disclosure Requirement*, later.

Regrouping by the IRS. If any of the activities resulting from your grouping is not an appropriate economic unit and one of the primary purposes of your grouping (or failure to regroup) is to avoid the passive activity rules, the IRS may regroup your activities.

Rental activities. In general, you cannot group a rental activity with a trade or business activity. However, you can group them together if the activities form an appropriate economic unit and:

- The rental activity is insubstantial in relation to the trade or business activity,
- The trade or business activity is insubstantial in relation to the rental activity, or
- Each owner of the trade or business activity has the same ownership interest in the rental activity, in which case the part of the rental activity that involves the rental of items of property for use in the trade or business activity may be grouped with the trade or business activity.

Example. Herbert and Wilma are married and file a joint return. Healthy Food, an S corporation, is a grocery store business. Herbert is Healthy Food's only shareholder. Plum Tower, an S corporation, owns and rents out the building. Wilma is Plum Tower's only shareholder. Plum Tower rents part of its building to Healthy Food. Plum Tower's grocery store rental business and Healthy Food's grocery business are not insubstantial in relation to each other.

Herbert and Wilma file a joint return, so they are treated as one taxpayer for purposes of the passive activity rules. The same owner (Herbert and Wilma) owns both Healthy Food and Plum Tower with the same ownership interest (100% in each). If the grouping forms an appropriate economic unit, as discussed earlier, Herbert and Wilma can group Plum Tower's grocery store rental and Healthy Food's grocery business into a single trade or business activity.

Grouping of real and personal property rentals. In general, you cannot treat an activity involving the rental of real property and an activity involving the rental of personal property as a single activity. However, you can treat them as a single activity if you provide the personal property in connection with the real property or the real property in connection with the personal property.

Certain activities may not be grouped. In general, if you own an interest as a limited partner or a limited entrepreneur in one of the following activities, you may not group that activity with any other activity in another type of business.

- Holding, producing, or distributing motion picture films or video tapes.
- Farming.
- Leasing any section 1245 property (as defined in section 1245(a)(3) of the Internal Revenue Code). For a list of section 1245 property, see *Section 1245 property* under *Activities Covered by the At-Risk Rules*, later.
- Exploring for, or exploiting, oil and gas resources.
- Exploring for, or exploiting, geothermal deposits.

If you own an interest as a limited partner or a limited entrepreneur in an activity described in the list above, you may group that activity with another activity in the same type of business if the grouping forms an appropriate economic unit as discussed earlier.

Limited entrepreneur. A limited entrepreneur is a person who:

- Has an interest in an enterprise other than as a limited partner, and
- Does not actively participate in the management of the enterprise.

Activities conducted through another entity. A personal service corporation, closely held corporation, partnership, or S corporation must group its activities using the rules discussed in this section. Once the entity groups its activities, you, as the partner or shareholder of the entity, may group those activities (following the rules of this section):

- With each other,
- With activities conducted directly by you, or
- With activities conducted through other entities.

CAUTION *You may not treat activities grouped together by the entity as separate activities.*

Personal service and closely held corporations. You may group an activity conducted through a personal service or closely held corporation with your other activities only to determine whether you materially or significantly participated in those other activities. See *Material Participation*, earlier, and *Significant Participation Passive Activities*, later.

Publicly traded partnership (PTP). You may not group activities conducted through a PTP with any other activity, including an activity conducted through another PTP.

Partial dispositions. If you dispose of substantially all of an activity during your tax year, you may treat the part disposed of as a separate activity. However, you can do this only if you can show with reasonable certainty:

- The amount of deductions and credits disallowed in prior years under the passive activity rules that is allocable to the part of the activity disposed of, and
- The amount of gross income and any other deductions and credits for the current tax year that is allocable to the part of the activity disposed of.

Regrouping Due to Net Investment Income Tax

You may be able to regroup your activities, as described below, if you are subject to the Net Investment Income Tax. For detailed information, see Regulations section 1.469-11(b)(3)(iv).

Regrouping on an original return. You can regroup your activities for 2015 on your original 2015 tax return, without regard to the manner in which the activities were grouped for 2014 if:

1. You did not previously regroup your activities under Regulations section 1.469-11(b)(3)(iv) due to the Net Investment Income Tax;
2. The amount you would have entered on Form 8960, line 12, without the regrouping, would have been greater than zero; and
3. The amount you would have entered on Form 8960, line 13, without the regrouping, would have been greater than the amount you would have entered on Form 8960, line 14 without the regrouping.

Regrouping on an amended return. You can regroup your activities for 2015 on an amended 2015 tax return, without regard to the manner in which the activities were grouped for 2014 if:

1. You did not previously regroup your activities under Regulations section 1.469-11(b)(3)(iv) due to the Net Investment Income Tax;
2. The limitation period for assessments for tax year 2015 under Code section 6501 has not ended;
3. The changes on your amended return cause the amount on Form 8960, line 12, of your amended return to be greater than zero; and
4. The changes on your amended return cause the amount on Form 8960, line 13, of your amended return to be greater than the amount entered on Form 8960, line 14.

This rule applies equally to changes to modified adjusted gross income or net investment income upon an IRS examination.

Manner of regrouping. If you regroup your activities under this rule, you must attach to your original or amended return, as applicable, a statement that satisfies the requirements described in *Regrouping* under *Disclosure Requirement*, later.

Disclosure Requirement

For tax years beginning after January 24, 2010, the following disclosure requirements for groupings apply. You are required to report certain changes to your groupings that occur during the tax year to the IRS. If you fail to report these changes, each trade or business activity or rental activity will be treated as a separate activity. You will be considered to have made a timely disclosure if you filed all affected income tax returns consistent with the claimed grouping and make the required disclosure on the income tax return for the year in which you first discovered the failure to disclose. If the IRS discovered the failure to disclose, you must have reasonable cause for not making the required disclosure.

New grouping. You must file a written statement with your original income tax return for the first tax year in which two or more activities are originally grouped into a single activity. The statement must provide the names, addresses, and employer identification numbers (EINs), if applicable, for the activities being grouped as a single activity. In addition, the statement must contain a declaration that the grouped activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules.

Addition to an existing grouping. You must file a written statement with your original income tax return for the tax year in which you add a new activity to an existing group. The statement must provide the name, address, and EIN, if applicable, for the activity that is being added and for the activities in the existing group. In addition, the statement must contain a declaration that the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules.

Regrouping. You must file a written statement with your original income tax return for the tax year in which you regroup the activities. The statement must provide the names, addresses, and EINs, if applicable, for the activities that are being regrouped. If two or more activities are

being regrouped into a single activity, the statement must contain a declaration that the regrouped activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules. In addition, the statement must contain an explanation of the material change in the facts and circumstances that made the original grouping clearly inappropriate.

Groupings by partnerships and S corporations. Partnerships and S corporations are not subject to the rules for new grouping, addition to an existing grouping, or regrouping. Instead, they must comply with the disclosure instructions for grouping activities provided in their Form 1065, U.S. Return of Partnership Income, or Form 1120S, U.S. Income Tax Return for an S Corporation, whichever is applicable.

The partner or shareholder is not required to make a separate disclosure of the groupings disclosed by the entity unless the partner or shareholder:

- Groups together any of the activities that the entity does not group together,
- Groups the entity's activities with activities conducted directly by the partner or shareholder, or
- Groups an entity's activities with activities conducted through another entity.

A partner or shareholder may not treat activities grouped together by the entity as separate activities.

Recharacterization of Passive Income

Net income from the following passive activities may have to be recharacterized and excluded from passive activity income.

- Significant participation passive activities,
- Rental of property when less than 30% of the unadjusted basis of the property is subject to depreciation,
- Equity-financed lending activities,
- Rental of property incidental to development activities,
- Rental of property to nonpassive activities, and
- Licensing of intangible property by pass-through entities.

If you are engaged in or have an interest in one of these activities during the tax year (either directly or through a partnership or an S corporation), combine the income and losses from the activity to determine if you have a net loss or net income from that activity.

If the result is a net loss, treat the income and losses the same as any other income or losses from that type of passive activity (trade or business activity or rental activity).

If the result is net income, do not enter any of the income or losses from the activity or property on Form 8582 or its worksheets. Instead, enter income or losses on the form and schedules you normally use. However, see *Significant Participation Passive Activities*, later, if the activity is a significant participation passive activity and you also have a net loss from a different significant participation passive activity.

Limit on recharacterized passive income. The total amount that you treat as nonpassive income under the rules described later in this discussion for significant participation passive activities, rental of nondepreciable property, and equity-financed lending activities cannot exceed the greatest amount that you treat as nonpassive income under any one of these rules.

Investment income and investment expense. To figure your investment interest expense limitation on Form 4952, treat as investment income any net passive income recharacterized as nonpassive income from rental of nondepreciable property, equity-financed lending activity, or licensing of intangible property by a pass-through entity.

Significant Participation Passive Activities

A significant participation passive activity is any trade or business activity in which you participated for more than 100 hours during the tax year but did not materially participate.

If your gross income from all significant participation passive activities is more than your deductions from those activities, a part of your net income from each significant participation passive activity is treated as nonpassive income.

Corporations. An activity of a personal service corporation or closely held corporation is a significant participation passive activity if both of the following statements are true.

- The corporation is not treated as materially participating in the activity for the year.
- One or more individuals, each of whom is treated as significantly participating in the activity, directly or indirectly hold (in total) more than 50% (by value) of the corporation's outstanding stock.

Worksheet A. Complete *Worksheet A. Significant Participation Passive Activities*, below, if you have income or losses from any significant participation activity. Begin by entering the name of each activity in the left column.

Column (a). Enter the number of hours you participated in each activity and total the column.

If the total is more than 500, do not complete Worksheet A or B. None of the activities are passive activities because you satisfy test 4 for material participation. (See *Material participation tests*, earlier.) Report all the income and losses from these activities on the forms and schedules you normally use. Do not include the income and losses on Form 8582.

Column (b). Enter the net loss, if any, from the activity. Net loss from an activity means either:

- The activity's current year net loss (if any) plus prior year unallowed losses (if any), or
- The excess of prior year unallowed losses over the current year net income (if any). Enter -0- here if the prior year unallowed loss is the same as the current year net income.

Column (c). Enter net income (if any) from the activity. Net income means the excess of the current year's net income from the activity over any prior year unallowed losses from the activity.

Column (d). Combine amounts in the *Totals* row for columns (b) and (c) and enter the total net income or net loss in the *Totals* row of column (d). If column (d) is a net loss, skip *Worksheet B. Significant Participation Activities With Net Income*. Include the income and losses in Worksheet 3 of Form 8582 (or Worksheet 2 in the Form 8810 instructions).

Worksheet A. **Significant Participation Passive Activities** *Keep for Your Records*

Name of activity	(a) Hours of participation	(b) Net loss	(c) Net income	(d) Combine totals of cols. (b) and (c)
		( )		
		( )		
		( )		
		( )		
		( )		
		( )		
		( )		
Totals		( )		

Worksheet B. On *Worksheet B. Significant Participation Activities With Net Income*, later, list only the significant participation passive activities that have net income as shown in column (c) of Worksheet A.

Column (a). Enter the net income of each activity from column (c) of Worksheet A.

Column (b). Divide each of the individual net income amounts in column (a) by the total of column (a). The result is a ratio. In column (b), enter the ratio for each activity as a decimal (rounded to at least three places). The total of these ratios must equal 1.000.

Column (c). Multiply the amount in the *Totals* row of column (d) of Worksheet A by each of the ratios in column (b). Enter the results in column (c).

Column (d). Subtract column (c) from column (a). To this figure, add the amount of prior year unallowed losses (if any) that reduced the current year net income. Enter the result in column (d). Enter these amounts on Worksheet 3 of Form 8582 or Worksheet 2 in the Form 8810 instructions. (Also, see *Limit on recharacterized passive income*, earlier.)

Rental of Nondepreciable Property

If you have net passive income (including prior year unallowed losses) from renting property in a rental activity, and less than 30% of the unadjusted basis of the property is subject to depreciation, you treat the net passive income as nonpassive income.

Example. Calvin acquires vacant land for $300,000, constructs improvements at a cost of $100,000, and leases the land and improvements to a tenant. He then sells the land and improvements for $600,000, realizing a gain of $200,000 on the disposition.

The unadjusted basis of the improvements ($100,000) equals 25% of the unadjusted basis of all property ($400,000) used in the rental activity. Calvin's net passive income from the activity (which is figured with the gain from the disposition, including gain from the improvements) is treated as nonpassive income.

Worksheet B. **Significant Participation Activities With Net Income** *Keep for Your Records*

Name of activity with net income	(a) Net income	(b) Ratio See instructions	(c) Nonpassive income See instructions	(d) Passive income Subtract col. (c) from col. (a)
Totals		1.000		

Equity-Financed Lending Activities

If you have gross income from an equity-financed lending activity, the lesser of the net passive income or the equity-financed interest income is nonpassive income.

For more information, see Temporary Regulations section 1.469-2T(f)(4).

Rental of Property Incidental to a Development Activity

Net income from this type of activity will be treated as nonpassive income if all of the following apply.

- You recognize gain from the sale, exchange, or other disposition of the rental property during the tax year.
- You started to rent the property less than 12 months before the date of disposition.
- You materially participated or significantly participated for any tax year in an activity that involved the performance of services for the purpose of enhancing the value of the property (or any other item of property if the basis of the property disposed of is determined in whole or in part by reference to the basis of that item of property).

For more information, see Regulations section 1.469-2(f)(5).

Rental of Property to a Nonpassive Activity

If you rent property to a trade or business activity in which you materially participated, net rental income from the property is treated as nonpassive income. This rule does not apply to net income from renting property under a written binding contract entered into before February 19, 1988. It also does not apply to property described earlier under *Rental of Property Incidental to a Development Activity*.

Licensing of Intangible Property by Pass-Through Entities

Net royalty income from intangible property held by a pass-through entity in which you own an interest may be treated as nonpassive royalty income. This applies if you acquired your interest in the pass-through entity after the partnership, S corporation, estate, or trust created the intangible property or performed substantial services or incurred substantial costs for developing or marketing the intangible property.

This recharacterization rule does not apply if:

1. The expenses reasonably incurred by the entity in developing or marketing the property exceed 50% of the gross royalties from licensing the property that are includible in your gross income for the tax year, or
2. Your share of the expenses reasonably incurred by the entity in developing or marketing the property for all tax years exceeded 25% of the fair market value of your interest in the intangible property at the time you acquired your interest in the entity.

For purposes of (2) above, capital expenditures are taken into account for the entity's tax year in which the expenditure is chargeable to a capital account, and your share of the expenditure is figured as if it were allowed as a deduction for the tax year.

Dispositions

Any passive activity losses (but not credits) that have not been allowed (including current year losses) generally are allowed in full in the tax year you dispose of your entire interest in the passive (or former passive) activity. However, for the losses to be allowed, you must dispose of your entire interest in the activity in a transaction in which all realized gain or loss is recognized. Also, the person acquiring the interest from you must not be related to you.

CAUTION *If you have a capital loss on the disposition of an interest in a passive activity, the loss may be limited. For individuals, your capital loss deduction is limited to the amount of your capital gains plus the lower of $3,000 ($1,500 in the case of a married individual filing a separate return) or the excess of your capital losses over capital gains. See* Publication 544 *for more information.*

Example. Ray earned a $60,000 salary and owned one passive activity through a 5% interest in the B Limited Partnership. In 2015, he sold his entire partnership interest to an unrelated person for $30,000. His adjusted basis in the partnership interest was $42,000, and he had carried over $2,000 of ordinary passive activity deductions from the activity.

Ray's deductible loss for 2015 is $5,000, figured as follows:

Amount realized	$30,000
Minus: adjusted basis	42,000
Capital loss	$12,000
Minus: capital loss limit	3,000
Capital loss carryover	$9,000
Allowable capital loss on sale	$3,000
Carryover losses allowable	2,000
Total current deductible loss	$5,000

Ray deducts the $5,000 total current deductible loss in 2015. He must carry over the remaining $9,000 capital loss, which is not subject to the passive activity loss limit. He will treat it like any other capital loss carryover.

Installment sale of an entire interest. If you sell your entire interest in a passive activity through an installment sale, to figure the loss for the current year that is not limited by the passive activity rules, multiply your overall loss (not including losses allowed in prior years) by a fraction. The numerator of the fraction is the gain recognized in the current year, and the denominator is the total gain from the sale minus all gains recognized in prior years.

Example. John Ash has a total gain of $10,000 from the sale of an entire interest in a passive activity. Under the installment method he reports $2,000 of gain each year, including the year of sale. For the first year, 20% (2,000/10,000) of the losses are allowed. For the second year, 25% (2,000/8,000) of the remaining losses are allowed.

Partners and S corporation shareholders. Generally, any gain or loss on the disposition of a partnership interest must be allocated to each trade or business, rental, or investment activity in which the partnership owns an interest. If you dispose of your entire interest in a partnership, the passive activity losses from the partnership that have not been allowed generally are allowed in full. They also will be allowed if the partnership (other than a PTP) disposes of all the property used in that passive activity.

If you do not dispose of your entire interest, the gain or loss allocated to a passive activity is treated as passive activity income or deduction in the year of disposition. This includes any gain recognized on a distribution of money from the partnership that you receive in excess of the adjusted basis of your partnership interest.

These rules also apply to the disposition of stock in an S corporation.

Dispositions by gift. If you give away your interest in a passive activity, the unused passive activity losses allocable to the interest cannot be deducted in any tax year. Instead, the basis of the transferred interest must be increased by the amount of these losses.

Dispositions by death. If a passive activity interest is transferred because the owner dies, unused passive activity losses are allowed (to a certain extent) as a deduction against the decedent's income in the year of death. The decedent's losses are allowed only to the extent they exceed the amount by which the transferee's basis in the passive activity has been increased under the rules for determining the basis of property acquired from a decedent. For example, if the basis of an interest in a passive activity in the hands of a transferee is increased by $6,000 and unused passive activity losses of $8,000 were allocable to the interest at the date of death, then the decedent's deduction for the tax year would be limited to $2,000 ($8,000 – $6,000).

If you inherited property from a decedent who died in 2010, special rules may apply if the executor of the estate files Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent. For more information, see Publication 4895, Tax Treatment of Property Acquired from a Decedent Dying in 2010, which is available at *www.irs.gov/publications/p4895/*.

Partial dispositions. If you dispose of substantially all of an activity during your tax year, you may be able to treat the part of the activity disposed of as a separate activity. See *Partial dispositions* under *Grouping Your Activities*, earlier.

How To Report Your Passive Activity Loss

More than one form or schedule may be required for reporting your passive activities. The actual number of forms depends on the number and types of activities you must report. Some forms and schedules that may be required are:

- Schedule C (Form 1040), Profit or Loss From Business,
- Schedule D (Form 1040), Capital Gains and Losses,
- Schedule E (Form 1040), Supplemental Income and Loss,
- Schedule F (Form 1040), Profit or Loss From Farming,
- Form 4797, Sales of Business Property,
- Form 6252, Installment Sale Income,
- Form 8582, Passive Activity Loss Limitations,
- Form 8582-CR, Passive Activity Credit Limitations, and
- Form 8949, Sales and Other Dispositions of Capital Assets.

Regardless of the number or complexity of passive activities you have, you should use only one Form 8582. If you need additional lines for any of the Form 8582 worksheets, you can either use copies of Form 8582 page 2 or page 3, whichever is applicable, or your own schedule that is in the same format as the worksheet.

For examples and further information, see the Form 8582 instructions.

At-Risk Limits

The at-risk rules limit your losses from most activities to your amount at risk in the activity. You treat any loss that is disallowed because of the at-risk limits as a deduction from the same activity in the next tax year. If your losses from an at-risk activity are allowed, they are subject to

recapture in later years if your amount at risk is reduced below zero.

You must apply the at-risk rules before the passive activity rules discussed in the first part of this publication.

Loss defined. A loss is the excess of allowable deductions from the activity for the year (including depreciation or amortization allowed or allowable and disregarding the at-risk limits) over income received or accrued from the activity during the year. Income does not include income from the recapture of previous losses (discussed later, under *Recapture Rule*).

Form 6198. Use Form 6198 to figure how much loss from an activity you can deduct.

1. You must file Form 6198 with your tax return if:
   a. You have a loss from any part of an activity that is covered by the at-risk rules, and
   b. You are not at risk for some of your investment in the activity.
2. You must file Form 6198 if you are engaged in an activity included in (6) under *Activities Covered by the At-Risk Rules*, later, and you have borrowed amounts described in *Certain borrowed amounts excluded* under *At-Risk Amounts,* later.

Loss limits for partners and S corporation shareholders. Four separate limits may apply to a partner's or shareholder's distributive share of an item of deduction or loss from a partnership or S corporation, respectively. The limits determine the amount each partner or shareholder can deduct on his or her own return. These limits and the order in which they apply are:

1. The adjusted basis of:
   a. The partner's partnership interest, or
   b. The shareholder's stock plus any loans the shareholder makes to the corporation,
2. The excess farm loss rules,
3. The at-risk rules, and
4. The passive activity rules.

See *Limitations on Losses, Deductions, and Credits* in Partner's Instructions for Schedule K-1 (Form 1065) and Shareholder's Instructions for Schedule K-1 (Form 1120S).

See *Coordination with other limitations on deductions that apply before the passive activity rules*, earlier.

Who Is Affected?

The at-risk limits apply to individuals (including partners and S corporation shareholders), estates, trusts, and certain closely held C corporations.

Closely held C corporation. For the at-risk rules, a C corporation is a closely held corporation if at any time during the last half of the tax year, more than 50% in value of its outstanding stock is owned directly or indirectly by or for five or fewer individuals.

To figure if more than 50% in value of the stock is owned by five or fewer individuals, apply the following rules.

1. Stock owned directly or indirectly by or for a corporation, partnership, estate, or trust is considered owned proportionately by its shareholders, partners, or beneficiaries.
2. An individual is considered to own the stock owned directly or indirectly by or for his or her family. Family includes only brothers and sisters (including half-brothers and half-sisters), a spouse, ancestors, and lineal descendants.
3. If a person holds an option to buy stock, he or she is considered to be the owner of that stock.
4. When applying rule (1) or (2), stock considered owned by a person under rule (1) or (3) is treated as actually owned by that person. Stock considered owned by an individual under rule (2) is not treated as owned by the individual for again applying rule (2) to consider another the owner of that stock.
5. Stock that may be considered owned by an individual under either rule (2) or (3) is considered owned by the individual under rule (3).

Activities Covered by the At-Risk Rules

If you are involved in one of the following activities as a trade or business or for the production of income, you are subject to the at-risk rules.

1. Holding, producing, or distributing motion picture films or video tapes.
2. Farming.
3. Leasing section 1245 property, including personal property and certain other tangible property that is depreciable or amortizable. See *Section 1245 property*, later.
4. Exploring for, or exploiting, oil and gas.
5. Exploring for, or exploiting, geothermal deposits (for wells started after September 1978).
6. Any other activity not included in (1) through (5) that is carried on as a trade or business or for the production of income.

Section 1245 property. Section 1245 property includes any property that is or has been subject to depreciation or amortization and is:

1. Personal property,
2. Other tangible property (other than a building or its structural components) that is:
   a. Used in manufacturing, production, extraction or furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services,
   b. A research facility used for the activities in (a), or
   c. A facility used in any of the activities in (a) for the bulk storage of fungible commodities,
3. Real property (other than property described in (2)) with an adjusted basis that was reduced by certain amortization deductions listed in section 1245(a)(3)(C) of the Internal Revenue Code,
4. A single purpose agricultural or horticultural structure, or
5. A storage facility (other than a building or its structural components) used for the distribution of petroleum.

Exception for holding real property placed in service before 1987. The at-risk rules do not apply to the holding of real property placed in service before 1987. They also do not apply to the holding of an interest acquired before 1987 in a pass-through entity engaged in holding real property placed in service before 1987. This exception does not apply to holding mineral property.

Personal property and services that are incidental to making real property available as living accommodations are included in the activity of holding real property. For example, making personal property, such as furniture, and services available when renting a hotel or motel room or a furnished apartment is considered incidental to making real property available as living accommodations.

Exception for equipment leasing by a closely held corporation. If a closely held corporation is actively engaged in equipment leasing, the equipment leasing is treated as a separate activity not covered by the at-risk rules. A closely held corporation is actively engaged in equipment leasing if 50% or more of its gross receipts for the tax year are from equipment leasing. Equipment leasing means the leasing, purchasing, servicing, and selling of equipment that is section 1245 property.

However, equipment leasing does not include the leasing of master sound recordings and similar contractual arrangements for tangible or intangible assets associated with literary, artistic, or musical properties, such as books, lithographs of artwork, or musical tapes. A closely held corporation cannot exclude these leasing activities from the at-risk rules nor count them as equipment leasing for the gross receipts test.

The equipment leasing exclusion also is not available for leasing activities related to other at-risk activities, such as motion picture films and video tapes, farming, oil and gas properties, and geothermal deposits. For example, if a closely held corporation leases a video tape, it cannot exclude this leasing activity from the at-risk rules under the equipment leasing exclusion.

Controlled group of corporations. A controlled group of corporations is subject to special rules for the equipment leasing exclusion. See section 465(c) of the Internal Revenue Code.

Special exception for qualified corporations. A qualified corporation is not subject to

the at-risk limits for any qualifying business carried on by the corporation. Each qualifying business is treated as a separate activity.

Qualified corporation. A qualified corporation is a closely held C corporation, defined earlier, that is not:

- A personal holding company, or
- A personal service corporation (defined in section 269A(b) of the Internal Revenue Code, but determined by substituting 5% for 10%).

Qualifying business. A qualifying business is any active business if all of the following apply.

1. During the entire 12-month period ending on the last day of the tax year, the corporation had at least:
   a. One full-time employee whose services were in the active management of the business, and
   b. Three full-time nonowner employees whose services were directly related to the business. A nonowner employee is an employee who does not own more than 5% in value of the outstanding stock of the corporation at any time during the tax year. (The rules for constructive ownership of stock in section 318 of the Internal Revenue Code apply. However, in applying these rules, an owner of 5% or more, rather than 50% or more, of the value of a corporation's stock is considered to own a proportionate share of any stock owned by the corporation.)
2. Deductions due to the business that are allowable to the corporation as business expenses and as contributions to certain employee benefit plans for the tax year exceed 15% of the gross income from the business.
3. The business is not an excluded business. Generally, an excluded business means equipment leasing as defined, earlier, under *Exception for equipment leasing by a closely held corporation*, and any business involving the use, exploitation, sale, lease, or other disposition of master sound recordings, motion picture films, video tapes, or tangible or intangible assets associated with literary, artistic, musical, or similar properties.

Separation of Activities

Generally, you treat your activity involving each film or video tape, item of leased section 1245 property, farm, oil and gas property, or geothermal property as a separate activity. In addition, each investment that is not a part of a trade or business is treated as a separate activity.

Leasing by a partnership or S corporation. For a partnership or S corporation, treat all leasing of section 1245 property that is placed in service in any tax year of the partnership or S corporation as one activity.

Aggregation of Activities

Activities described in (6) under *Activities Covered by the At-Risk Rules*, earlier, that constitute a trade or business are treated as one activity if:

- You actively participate in the management of the trade or business, or
- The trade or business is carried on by a partnership or S corporation and 65% or more of its losses for the tax year are allocable to persons who actively participate in the management of the trade or business.

Similar rules apply to activities described in (1) through (5) of that earlier discussion.

Active participation. Active participation depends on all the facts and circumstances. Factors that indicate active participation include making decisions involving the operation or management of the activity, performing services for the activity, and hiring and discharging employees. Factors that indicate a lack of active participation include lack of control in managing and operating the activity, having authority only to discharge the manager of the activity, and having a manager of the activity who is an independent contractor rather than an employee.

Partners and S corporation shareholders. Partners or shareholders may aggregate activities of their partnership or S corporation within each of the following categories.

- Films and video tapes,
- Farms,
- Oil and gas properties, and
- Geothermal properties.

For example, if a partnership or S corporation produces two films or video tapes, the partners or S corporation shareholders may treat the production of both films or video tapes as one activity for purposes of the at-risk rules.

At-Risk Amounts

You are at risk in any activity for:

1. The money and adjusted basis of property you contribute to the activity, and
2. Amounts you borrow for use in the activity if:
   a. You are personally liable for repayment, or
   b. You pledge property (other than property used in the activity) as security for the loan.

Amounts borrowed. You are at risk for amounts borrowed to use in the activity if you are personally liable for repayment. You are also at risk if the amounts borrowed are secured by property other than property used in the activity. In this case, the amount considered at risk is the net fair market value of your interest in the pledged property. The net fair market value of property is its fair market value (determined on the date the property is pledged) less any prior (or superior) claims to which it is subject. However, no property will be taken into account as security if it is directly or indirectly financed by debt that is secured by property you contributed to the activity.

CAUTION *If you borrow money to finance a contribution to an activity, you cannot increase your amount at risk by the contribution and the amount borrowed to finance the contribution. You may increase your at-risk amount only once.*

Certain borrowed amounts excluded. Even if you are personally liable for the repayment of a borrowed amount or you secure a borrowed amount with property other than property used in the activity, you are not considered at risk if you borrowed the money from a person having an interest in the activity or from someone related to a person (other than you) having an interest in the activity. This does not apply to:

- Amounts borrowed by a corporation from a person whose only interest in the activity is as a shareholder of the corporation,
- Amounts borrowed from a person having an interest in the activity as a creditor, or
- Amounts borrowed after May 3, 2004, secured by real property used in the activity of holding real property (other than mineral property) that, if nonrecourse, would be qualified nonrecourse financing.

Related persons. Related persons include:

- Members of a family, but only an individual's brothers and sisters, half-brothers and half-sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.),
- Two corporations that are members of the same controlled group of corporations determined by applying a 10% ownership test,
- The fiduciaries of two different trusts, or the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts,
- A tax-exempt educational or charitable organization and a person who directly or indirectly controls it (or a member of whose family controls it),
- A corporation and an individual who owns directly or indirectly more than 10% of the value of the outstanding stock of the corporation,
- A trust fiduciary and a corporation of which more than 10% in value of the outstanding stock is owned directly or indirectly by or for the trust or by or for the grantor of the trust,
- The grantor and fiduciary, or the fiduciary and beneficiary, of any trust,
- A corporation and a partnership if the same persons own more than 10% in value of the outstanding stock of the corporation and more than 10% of the capital interest or the profits interest in the partnership,
- Two S corporations if the same persons own more than 10% in value of the outstanding stock of each corporation,
- An S corporation and a regular corporation if the same persons own more than 10% in value of the outstanding stock of each corporation,

- A partnership and a person who owns directly or indirectly more than 10% of the capital or profits of the partnership,
- Two partnerships if the same persons directly or indirectly own more than 10% of the capital or profits of each,
- Two persons who are engaged in business under common control, and
- An executor of an estate and a beneficiary of that estate.

To determine the direct or indirect ownership of the outstanding stock of a corporation, apply the following rules.

1. Stock owned directly or indirectly by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries.
2. Stock owned directly or indirectly by or for an individual's family is considered owned by the individual. The family of an individual includes only brothers and sisters, half-brothers and half-sisters, a spouse, ancestors, and lineal descendants.
3. Any stock in a corporation owned by an individual (other than by applying rule (2)) is considered owned directly or indirectly by the individual's partner.
4. When applying rule (1), (2), or (3), stock considered owned by a person under rule (1) is treated as actually owned by that person. But, if a person constructively owns stock because of rule (2) or (3), he or she does not own the stock for purposes of applying either rule (2) or (3) to make another person the constructive owner of the same stock.

Effect of government price support programs. A government target price program or other government price support programs for a product that you grow does not, without agreements limiting your costs, reduce the amount you have at risk.

Effect of increasing amounts at risk in subsequent years. Any loss that is allowable in a particular year reduces your at-risk investment (but not below zero) as of the beginning of the next tax year and in all succeeding tax years for that activity. If you have a loss that is more than your at-risk amount, the loss disallowed will not be allowed in later years unless you increase your at-risk amount. Losses that are suspended because they are greater than your investment that is at risk are treated as a deduction for the activity in the following year. Consequently, if your amount at risk increases in later years, you may deduct previously suspended losses to the extent that the increases in your amount at risk exceed your losses in later years. However, your deduction of suspended losses may be limited by the passive loss rules.

Amounts Not At Risk

You are not considered at risk for amounts protected against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements.

Nonrecourse financing. Nonrecourse financing is financing for which you are not personally liable. If you borrow money to contribute to an activity and the lender's only recourse is to your interest in the activity or the property used in the activity, the loan is a nonrecourse loan.

You are not considered at risk for your share of any nonrecourse loan used to finance an activity or to acquire property used in the activity unless the loan is secured by property not used in the activity.

However, you are considered at risk for qualified nonrecourse financing secured by real property used in an activity of holding real property. Qualified nonrecourse financing is financing for which no one is personally liable for repayment and that is:

- Borrowed by you in connection with the activity of holding real property,
- Secured by real property used in the activity,
- Not convertible from a debt obligation to an ownership interest, and
- Loaned or guaranteed by any federal, state, or local government, or borrowed by you from a qualified person.

Other types of property used as security. The rules in the next two paragraphs apply to any financing incurred after August 3, 1998. You also can choose to apply these rules to financing you obtained before August 4, 1998. If you do that, you must reduce the amounts at risk as a result of applying these rules to years ending before August 4, 1998, to the extent they increase the losses allowed for those years.

In determining whether qualified nonrecourse financing is secured only by real property used in the activity of holding real property, disregard property that is incidental to the activity of holding real property. Also disregard other property if the total gross fair market value of that property is less than 10% of the total gross fair market value of all the property securing the financing.

For this purpose, treat yourself as owning directly your proportional share of the assets in any partnership in which you own, directly or indirectly, an equity interest.

Qualified person. A qualified person is a person who actively and regularly engages in the business of lending money. The most common example is a bank.

However, none of the following persons can be a qualified person.

- A person related to you in one of the ways listed under *Related persons*, earlier. However, a person related to you may be a qualified person if the nonrecourse financing is commercially reasonable and on the same terms as loans involving unrelated persons.
- A person from which you acquired the property or a person related to that person.
- A person who receives a fee due to your investment in the real property or a person related to that person.

Other loss limiting arrangements. Any capital you have contributed to an activity is not at risk if you are protected against economic loss by an agreement or arrangement for compensation or reimbursement. For example, you are not at risk if you will be reimbursed for part or all of any loss because of a binding agreement between yourself and another person.

Example 1. Some commercial feedlots reimburse investors against any loss sustained on sales of the fed livestock above a stated dollar amount per head. Under such stop loss orders, the investor is at risk only for the portion of the investor's capital for which the investor is not entitled to a reimbursement.

Example 2. You are personally liable for a mortgage, but you separately obtain insurance to compensate you for any payments you must actually make because of your personal liability. You are considered at risk only to the extent of the uninsured portion of the personal liability to which you are exposed. You can include in the amount you have at risk the amount of any premium which you paid from your personal assets for the insurance. However, if you obtain casualty insurance or insurance protecting yourself against tort liability, it does not affect the amount you are otherwise considered to have at risk.

Reductions of Amounts At Risk

The amount you have at risk in any activity is reduced by any losses allowed in previous years under the at-risk rules. It may also be reduced because of distributions you received from the activity, debts changed from recourse to nonrecourse, or the initiation of a stop loss or similar agreement. If the amount at risk is reduced below zero, your previously allowed losses are subject to recapture, as explained next.

Recapture Rule

If the amount you have at risk in any activity at the end of any tax year is less than zero, you must recapture at least part of your previously allowed losses. You do this by adding to your income from the activity for that year the lesser of the following amounts:

- The negative at-risk amount (treated as a positive amount), or
- The total amount of losses deducted in previous tax years beginning after 1978, minus any amounts you previously added to your income from that activity under this recapture rule.

Do not use the recapture income to reduce any net loss from the activity for the tax year. Instead, treat the recaptured amount as a deduction for the activity in the next tax year.

Pre-1979 activity. If the amount you had at risk in an activity at the end of your tax year that began in 1978 was less than zero, you apply the preceding rule for the recapture of losses by substituting that negative amount for zero. For example, if your at-risk amount for that tax year was minus $50, you will recapture losses only when your at-risk amount goes below minus $50.

How To Get Tax Help

If you have questions about a tax issue, need help preparing your tax return, or want to download free publications, forms, or instructions, go to IRS.gov and find resources that can help you right away.

Preparing and filing your tax return. Find free options to prepare and file your return on IRS.gov or in your local community if you qualify.

- Go to IRS.gov and click on the Filing tab to see your options.
- Enter "Free File" in the search box to see whether you can use brand-name software to prepare and *e-file* your federal tax return for free.
- Enter "VITA" in the search box, download the free IRS2Go app, or call 1-800-906-9887 to find the nearest Volunteer Income Tax Assistance or Tax Counseling for the Elderly (TCE) location for free tax preparation.
- Enter "TCE" in the search box, download the free IRS2Go app, or call 1-888-227-7669 to find the nearest Tax Counseling for the Elderly location for free tax preparation.

The Volunteer Income Tax Assistance (VITA) program offers free tax help to people who generally make $54,000 or less, persons with disabilities, the elderly, and limited-English-speaking taxpayers who need help preparing their own tax returns. The Tax Counseling for the Elderly (TCE) program offers free tax help for all taxpayers, particularly those who are 60 years of age and older. TCE volunteers specialize in answering questions about pensions and retirement-related issues unique to seniors.

Getting answers to your tax law questions. On IRS.gov get answers to your tax questions anytime, anywhere.

- Go to *www.irs.gov/Help-&-Resources* for a variety of tools that will help you with your taxes.
- Enter "ITA" in the search box on IRS.gov for the Interactive Tax Assistant, a tool that will ask you questions on a number of tax law topics and provide answers. You can print the entire interview and the final response.
- Enter "Pub 17" in the search box on IRS.gov to get Pub. 17, Your Federal Income Tax for Individuals, which features details on tax-saving opportunities, 2015 tax changes, and thousands of interactive links to help you find answers to your questions.
- Additionally, you may be able to access tax law information in your electronic filing software.

Tax forms and publications. You can download or print all of the forms and publications you may need on *www.irs.gov/formspubs*. Otherwise, you can go to *www.irs.gov/orderforms* to place an order and have forms mailed to you. You should receive your order within 10 business days.

Direct deposit. The fastest way to receive a tax refund is by combining direct deposit and IRS *e-file*. Direct deposit securely and electronically transfers your refund directly into your financial account. Eight in 10 taxpayers use direct deposit to receive their refund. The majority of refunds are received within 21 days or less.

Getting a transcript or copy of a return.

- Go to IRS.gov and click on "Get Transcript of Your Tax Records" under "Tools."
- Call the transcript toll-free line at 1-800-908-9946.
- Mail Form 4506-T or Form 4506T-EZ (both available on IRS.gov).

Using online tools to help prepare your return. Go to IRS.gov and click on the Tools bar to use these and other self-service options.

- The *Earned Income Tax Credit Assistant* determines if you are eligible for the EIC.
- The *Online EIN Application* helps you get an employer identification number.
- The *IRS Withholding Calculator* estimates the amount you should have withheld from your paycheck for federal income tax purposes.
- The *Electronic Filing PIN Request* helps to verify your identity when you do not have your prior year AGI or prior year self-selected PIN available.
- The *First Time Homebuyer Credit Account Look-up* tool provides information on your repayments and account balance.

For help with the alternative minimum tax, go to IRS.gov/AMT.

Understanding identity theft issues.

- Go to *www.irs.gov/uac/Identity-Protection* for information and videos.
- If your SSN has been lost or stolen or you suspect you are a victim of tax-related identity theft, visit *www.irs.gov/identitytheft* to learn what steps you should take.

Checking on the status of a refund.

- Go to *www.irs.gov/refunds*.
- Download the free IRS2Go app to your smart phone and use it to check your refund status.
- Call the automated refund hotline at 1-800-829-1954.

Making a tax payment. The IRS uses the latest encryption technology so electronic payments are safe and secure. You can make electronic payments online, by phone, or from a mobile device. Paying electronically is quick, easy, and faster than mailing in a check or money order. Go to *www.irs.gov/payments* to make a payment using any of the following options.

- *IRS Direct Pay* (for individual taxpayers who have a checking or savings account).
- **Debit or credit card** (approved payment processors online or by phone).
- **Electronic Funds Withdrawal** (available during *e-file*).
- **Electronic Federal Tax Payment System** (best option for businesses; enrollment required).
- **Check or money order**.
- IRS2Go provides access to mobile-friendly payment options like IRS Direct Pay, offering you a free, secure way to pay directly from your bank account. You can also make debit or credit card payments through an approved payment processor. Simply download IRS2Go from Google Play, the Apple App Store, or the Amazon Appstore, and make your payments anytime, anywhere.

What if I can't pay now? Click on the "Pay Your Tax Bill" icon on IRS.gov for more information about these additional options.

- Apply for an *online payment agreement* to meet your tax obligation in monthly installments if you cannot pay your taxes in full today. Once you complete the online process, you will receive immediate notification of whether your agreement has been approved.
- An offer in compromise allows you to settle your tax debt for less than the full amount you owe. Use the *Offer in Compromise Pre-Qualifier* to confirm your eligibility.

Checking the status of an amended return. Go to IRS.gov and click on the Tools tab and then *Where's My Amended Return?*

Understanding an IRS notice or letter. Enter "Understanding your notice" in the search box on IRS.gov to find additional information about your IRS notice or letter.

Visiting the IRS. Locate the nearest Taxpayer Assistance Center using the Office Locator tool on IRS.gov. Enter "office locator" in the search box. Or choose the "Contact Us" option on the IRS2Go app and search Local Offices. Before you visit, use the Locator tool to check hours and services available.

Watching IRS videos. The IRS Video portal *www.irsvideos.gov* contains video and audio presentations for individuals, small businesses, and tax professionals. You'll find video clips of tax topics, archived versions of panel discussions and Webinars, and audio archives of tax practitioner phone forums.

Getting tax information in other languages. For taxpayers whose native language is not English, we have the following resources available.

1. Taxpayers can find information on IRS.gov in the following languages.
   a. *Spanish*.
   b. *Chinese*.
   c. *Vietnamese*.
   d. *Korean*.
   e. *Russian*.
2. The IRS Taxpayer Assistance Centers provide over-the-phone interpreter service in over 170 languages, and the service is available free to taxpayers.

The Taxpayer Advocate Service Is Here To Help You

What is the Taxpayer Advocate Service?

The Taxpayer Advocate Service (TAS) is an ***independent*** organization within the Internal Revenue Service that helps taxpayers and protects taxpayer rights. Our job is to ensure that every taxpayer is treated fairly and that you know and understand your rights under the *Taxpayer Bill of Rights*.

What Can the Taxpayer Advocate Service Do For You?

We can help you resolve problems that you can't resolve with the IRS. And our service is free. If you qualify for our assistance, you will be assigned to one advocate who will work with you throughout the process and will do everything possible to resolve your issue. TAS can help you if:

- Your problem is causing financial difficulty for you, your family, or your business,
- You face (or your business is facing) an immediate threat of adverse action, or
- You've tried repeatedly to contact the IRS but no one has responded, or the IRS hasn't responded by the date promised.

How Can You Reach Us?

We have offices *in every state, the District of Columbia, and Puerto Rico*. Your local advocate's number is in your local directory and at *www.taxpayeradvocate.irs.gov*. You can also call us at 1-877-777-4778.

How Can You Learn About Your Taxpayer Rights?

The Taxpayer Bill of Rights describes ten basic rights that all taxpayers have when dealing with the IRS. Our Tax Toolkit at *www.taxpayeradvocate.irs.gov* can help you understand *what these rights mean to you* and how they apply. These are ***your*** rights. Know them. Use them.

How Else Does the Taxpayer Advocate Service Help Taxpayers?

TAS works to resolve large-scale problems that affect many taxpayers. If you know of one of these broad issues, please report it to us at *www.irs.gov/sams*.

Low Income Taxpayer Clinics

Low Income Taxpayer Clinics (LITCs) serve individuals whose income is below a certain level and need to resolve tax problems such as audits, appeals, and tax collection disputes. Some clinics can provide information about taxpayer rights and responsibilities in different languages for individuals who speak English as a second language. To find a clinic near you, visit *www.irs.gov/litc* or see IRS Publication 4134, *Low Income Taxpayer Clinic List*.

Index

To help us develop a more useful index, please let us know if you have ideas for index entries. See "Comments and Suggestions" in the "Introduction" for the ways you can reach us.

A

Active participation 14
Activity:
- Appropriate economic unit 8
- Nonpassive 5
- Trade or business 3

Amounts borrowed 14
Amounts not at risk 15
Appropriate economic unit 8
Assistance (*See* Tax help)
At-risk activities:
- Aggregation of 14
- Separation of 14

At-risk amounts 14
- Government price support programs 15
- Increasing amounts 15
- Nonrecourse financing 15

At-risk limits 12
- Closely held corporation 13
- Loss defined 13
- Partners 13
- S corporation shareholders 13
- Who is affected 13

At-risk rules:
- Activities covered by 13
- Exceptions to 13
- Excluded business 14
- Qualified corporation 14
- Qualifying business 14
- Recapture rule 15

B

Borrowed amounts 14

C

Closely held corporation 13
Commercial revitalization deduction 4
Corporations:
- Closely held 6, 10
- Controlled group of 13
- Personal service 6, 10
- Qualified 14

CRD 4

D

Deductions, passive activity 7
Disabled farmer 6
Disclosure requirement 9
Dispositions:
- Death 12
- Gift 12
- Installment sale 12
- Partial 9

E

Excluded business, definition of 14

F

Farmer 6
Farm loss 3
Form:
- 6198 13
- 8810 2

Former passive activity 3

G

Grouping passive activities 8

I

Identity theft 16
Income, passive activity 6

L

Limited entrepreneur 9
Limited partners 6

M

Material participation 5, 6
Modified adjusted gross income 4

N

Nonrecourse loan 15

P

Participation 5
- Active 14
- Material 5

Passive activity 2, 12
- Disposition 12
- Former 3
- Grouping 8
- Limits 2
- Material participation 5
- Rental 3
- Rules 3, 8
- Who must use these rules 2

Passive activity deductions 7
Passive activity income 6
Passive income, recharacterization of 10
Publications (*See* Tax help)
Publicly traded partnership 3, 9

Q

Qualified person, nonrecourse financing 15
Qualifying business, at-risk rules 14

R

Real estate professional 6
Recapture rule under at-risk limits 15
Recharacterization of passive income 10
Reductions of amounts at risk 15
Related persons 14
Rental activity:
- $25,000 offset 4
- Active participation 4
- Exceptions 3
- Phaseout rule 4
- Real estate professional 6

Retired farmer 6

S

Section 1245 property 13
Self-charged interest 6
Separate activity 14
Significant participation passive activities 10
Special $25,000 allowance 4
Surviving spouse of farmer 6

T

Tax help 16
Trade or business activities:
- Definition of 3
- Real property 6

W

Worksheet A 10, 11
Worksheet B 11