Department of the Treasury

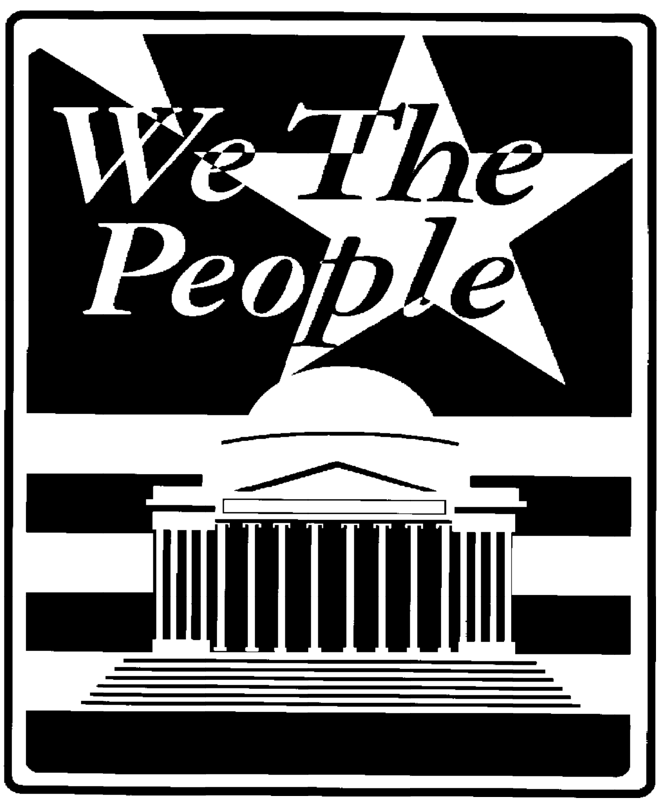
Internal Revenue Service

Publication 925
Cat. No. 64265X

Passive Activity and At-Risk Rules

For use in preparing

1994 Returns



Contents

Introduction

This publication discusses two sets of rules that may limit the losses that you can deduct on your tax return from any trade, business, or income-producing activity. The first part of the publication contains 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.

Useful Items

You may want to see:

Publication

- ❏ **527** Residential Rental Property (Including Rental of Vacation Homes)
- ❏ **541** Tax Information on Partnerships
- ❏ **589** Tax Information on S Corporations

Form (and Instructions)

- ❏ **4952** Investment Interest Expense Deduction
- ❏ **6198** At-Risk Limitations
- ❏ **8582** Passive Activity Loss Limitations
- ❏ **8582–CR** Passive Activity Credit Limitations

Ordering publications and forms. To order free publications and forms, call our toll-free telephone number, 1–800–TAX–FORM (1–800–829–3676). You can also write to the Internal Revenue Service Forms Distribution Center nearest you. Check your income tax package for the address.

Telephone help for hearing-impaired persons. If you have access to TDD equipment, you can call **1–800–829–4059** with your tax questions or to order forms and publications. See your tax package for the hours of operation.

Passive Activity Limits

Before you use the passive activity rules, ***determine your amount at risk*** in the activity. The at-risk rules are explained in the second part of this publication. After you figure your amount at risk, apply the rules in this part to find your passive activity losses and the amount you can deduct.

In general, you are allowed to deduct passive activity losses only from passive activity income. The excess is carried forward to the following year or years until used, or until you dispose of your entire interest in the activity in a fully taxable transaction. See *Dispositions,* later.

You can take ***passive activity credits*** only from tax on net passive income. Passive activity credits include the general business credit and other special business credits, such as the orphan drug credit and the credit for fuel produced from a nonconventional source. Credits in excess of the tax on income from passive activities are also carried forward.

Unallowed passive activity credits, unlike unallowed passive activity losses, are not deductible when you dispose of your entire interest in an activity. However, you can elect to increase the basis of your interest in the activity by the amount of the original basis reduction for the credit to the extent that the credit was not allowed because of the passive activity limits. You cannot elect to adjust the basis for a partial disposition of your interest in a passive activity. See Form 8582-CR, *Passive Activity Credit Limitations,* for more information.

Treatment of former passive activities. A former passive activity is an activity that is not a passive activity in the current tax year, but was a passive activity in any earlier tax year. If a former passive activity has net income in the current year and a prior year unallowed loss, you can offset the net income for that activity by the prior year unallowed loss (but not below zero). Treat any remaining prior year unallowed loss like you treat any other passive loss.

You can offset the allocable part of your current year tax liability with any prior year unallowed passive activity credits from that activity. The allocable part of your current year tax liability refers to that part of this years tax liability that is allocable to the current year net income from the former passive activity. This is figured after you reduce your net income from a former passive activity by any prior year unallowed loss from that activity (but not below zero).

Who Must Use These Rules

The passive activity rules apply to:

1) Individuals,
2) Estates,
3) Trusts (other than grantor trusts),
4) Personal service corporations, and
5) Closely held corporations.

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

Personal service corporation. For the passive activity rules, a corporation is a personal service corporation if it meets all of the following requirements.

1) It is a corporation (other than an S corporation).
2) Its principal activity during the ''testing period'' is performing personal services. The testing period for any tax year is the previous tax year. If the corporation has just been formed, the testing period begins on the first day of its tax year and ends on the earlier of:
   a) The last day of its tax year, or
   b) The last day of the calendar year in which its tax year begins.
3) The services in (2) must be substantially performed by employee-owners. This is met if more than 20% of the corporation's compensation cost for its activities of performing personal services during the testing period is performed by employee-owners.
4) Its employee-owners own more than 10% of the fair market value of its outstanding stock on the last day of the testing period.

Personal services. Personal services are those in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, and consulting.

Employee-owners. A person is an employee-owner of a personal service corporation if both of the following apply.

1) He or she is an employee, or performs personal services for or on behalf of the corporation as an independent contractor, during any day of the testing period, and
2) He or she owns any stock in the corporation at any time during the testing period.

Closely held corporation. A corporation is closely held if all of the following apply.

1) It is a corporation (other than an S corporation).
2) It is not a personal service corporation, defined earlier.
3) At any time during the last half of the tax year, more than 50% of the value of its outstanding stock is directly or indirectly owned by five or fewer individuals. ''Individual'' includes certain trusts and private foundations.

Identifying Your Activities (Final Rules)

Caution: Generally, the rules in this section are effective for tax years ending after May 10, 1992. However, for tax years that ended after May 10, 1992, but began before October 4, 1994, you can use the rules discussed later under *Identifying Your Activities (Proposed Rules).* For your tax year that included May 10, 1992, you have another choice. You can instead choose to use the rules in expired Temporary Regulation 1.469-4T.

To determine your passive losses, you must first identify your activities. You may 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.

Appropriate Economic Units

Generally, to determine if more than one activity forms an appropriate economic unit, you must consider all the relevant facts and circumstances. You may 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 are treated as 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 reliance between or among activities which includes the extent that the activities:
   a) Purchase 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 has a significant ownership interest in a bakery and a movie theater at a shopping mall in Baltimore and in a bakery and movie theater in Philadelphia. Depending 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:

1) One activity,
2) A movie theater activity and a bakery activity,
3) A Baltimore activity and a Philadelphia activity, or
4) Four separate activities.

Example 2. Betty is a partner in ABC partnership which sells non-food items to grocery stores. Betty is also a partner in DEF (a trucking business). ABC and DEF are under common control. The predominate part of DEF's business is transporting goods for ABC. DEF is the only trucking business in which Betty is involved. Following 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 that the IRS may have 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 that the IRS may have.

Regrouping by IRS. If any of the activities resulting from your grouping is not an appropriate economic unit and a principal purpose of your grouping (or failure to regroup) is to get around the passive activity rules, the IRS may regroup your activities.

Rental activities. In general, a rental activity may **not** be grouped with a trade or business activity. However, you may group them together if the activities form an appropriate economic unit and:

1) The rental activity is insubstantial in relation to the trade or business activity,
2) The trade or business activity is insubstantial in relation to the rental activity, or
3) 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 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, and Herbert is Healthy Food's only shareholder. Plum Tower, an S corporation, owns and rents out a building, and Wilma is Plum Tower's only shareholder. Plum Tower rents part of its building to Healthy Food. Plum Tower's rental business and Healthy Food's grocery business are not insubstantial in relation to each other.

Because Herbert and Wilma file a joint return, they are treated as one taxpayer for purposes of the passive loss rules. So Healthy Food and Plum Tower are owned by the same owner (Herbert and Wilma) with the same ownership interest (100% in each). If the grouping forms an appropriate economic unit, as discussed earlier, Plum Tower's rental to Healthy Food's grocery business may be grouped together into a single trade or business activity.

Grouping of real and personal property rentals. In general, an activity involving the rental of real property and an activity involving the rental of personal property **cannot** be treated as a single activity. However, personal property provided in connection with the real property may be treated as a single activity. Also, real property provided in connection with the personal property may be treated as a single activity.

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:

1) Holding, producing, or distributing motion picture films or video tapes,
2) Farming,
3) Leasing any section 1245 property (as defined in section 1245(a)(3)),
4) Exploring for, or exploiting, oil and gas resources, or
5) 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:

1) Has an interest in an enterprise other than as a limited partner, and
2) 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 same 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 as the shareholder or partner, and

With activities conducted through other entities.

You, as a shareholder or partner, may **not treat** activities grouped together by a personal service corporation, closely held corporation, partnership, or S corporation as separate activities.

Activities conducted through certain corporations. The grouping of a personal service or closely held corporation's activities with your other activities only affects the determination of material or significant participation discussed later, under *Material Participation* and *Recharacterization of Passive Income.*

Publicly Traded Partnerships (PTPs). You may not combine operations held through a PTP with any other operations you own, including operations you hold through another PTP. See *Publicly Traded Partnerships (PTPs)* in the Instructions for Form 8582, *Passive Activity Loss Limitations.*

Other activities. The IRS may issue guidance that identifies other activities that may not be grouped with any other activity except as allowed by the IRS in the guidance. The IRS publishes this guidance in the Internal Revenue Bulletin.

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. But, you can only do this if you can show with reasonable certainty:

1) The amount of prior year deductions and credits disallowed under the passive loss rules that is allocable to the part of the activity disposed of, and
2) 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.

Identifying Your Activities (Proposed Rules)

Caution: Generally, the rules discussed previously under *Identifying Your Activities (Final Rules)* apply to tax years ending after May 10, 1992. However, you can choose to use the rules discussed here for tax years that ended after May 10, 1992, but began before October 4, 1994. You have another choice for your tax year that included May 10, 1992. You can choose to have the rules in expired Temporary Regulation 1.469-4T apply.

To determine your passive losses, you must first identify your activities. Generally, you can treat one or more trade or business activities as a single activity if those activities form an ***appropriate economic unit*** for measuring gain or loss under the passive activity rules.

Appropriate Economic Units

To determine if more than one activity forms an appropriate economic unit, you must consider all the relevant facts and circumstances. You may 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 are treated as an appropriate economic unit. It is not necessary to have all the factors to treat more than one activity as a single activity. The factors that you should consider are:

- The similarities and differences in types of business,
- The extent of common control,
- The extent of common ownership,
- The geographical location, and

- The interdependencies between the activities.

By interdependencies between the activities, we mean the extent that the activities:

1) Purchase or sell goods among themselves,
2) Involve products or services that are generally provided together,
3) Have the same customers,
4) Have the same employees, or
5) Use a single set of books and records to account for the activities.

Example. John Jackson has a significant ownership interest in a bakery and a movie theater at a shopping mall in Baltimore and in a bakery and movie theater in Philadelphia. Depending on other relevant facts and circumstances, John may group the movie theaters and the bakeries into:

1) One activity,
2) A movie theater activity and a bakery activity,
3) A Baltimore activity and a Philadelphia activity, or
4) Four separate activities.

Consistency requirement. Generally, when you group activities into appropriate economic units, you may not regroup those activities in a later tax year. 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 you must comply with the disclosure requirements of the IRS. If your grouping fails to reflect one or more appropriate economic units and one of your primary purposes in grouping activities is to get around the passive activity rules, the IRS may regroup your activities.

Rental activities. In general, a rental activity may **not** be grouped with a trade or business activity. However, you can group them together if the rental activity is insubstantial in relation to the trade or business activity, or the trade or business activity is insubstantial in relation to the rental activity.

In general, an activity involving the rental of real property and an activity involving the rental of personal property **cannot** be treated as a single activity. However, personal property provided in connection with the real property may be treated as a single activity.

Limitation on grouping certain items. In general, if you are a limited partner or a limited entrepreneur in one of the following activities, you may not group that activity with any other activity:

1) Holding, producing, or distributing motion picture films or video tapes,
2) Farming,
3) Leasing any section 1245 property (as defined in section 1245(a)(3)),
4) Exploring for, or exploiting, oil and gas resources, or
5) Exploring for, or exploiting, geothermal deposits.

If you are a limited partner or a limited entrepreneur in an activity described in the list above, you may group that activity with:

Another activity that is in the same type of business if you are a limited partner or limited entrepreneur in both activities, or

Another activity in which you are not a limited partner or a limited entrepreneur if the activity is the same type of business and if the grouping is appropriate considering the relevant facts and circumstances discussed earlier, under *Appropriate Economic Units*.

Limited entrepreneur. A limited entrepreneur is a person who:

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

Activities conducted through partnerships or S corporations. A partnership or S corporation must group its activities using the same rules discussed in this section. Once the partnership or S corporation determines its activities, you as the partner or shareholder may group those activities with your activities that are conducted:

Directly by you as the shareholder or partner, or

Through other partnerships or S corporations of which you are a partner or shareholder.

Publicly Traded Partnerships (PTPs). You may not combine operations held through a PTP with any other operations you own, including operations you hold through another PTP. See *Publicly Traded Partnerships (PTPs)* in the Instructions for Form 8582, *Passive Activity Loss Limitations.*

Partial dispositions. If you dispose of a substantial part of an activity during your tax year, you may treat that part of an activity as a separate activity. However, to treat the disposition of a substantial part of an activity as a separate activity, you must show with reasonable certainty:

1) The amount of prior year deductions and credits disallowed under the passive loss rules that is allocable to the substantial part of the activity, and
2) The amount of gross income and any other deductions and credits that is allocable to the substantial part of the activity for the current tax year.

Passive Activities

There are two kinds of passive activities—trade or business activities in which you do not materially participate (defined later) during the tax year, and rental activities (discussed later).

Trade or Business Activities

A trade or business activity is an activity that:

1) Involves the conduct of a trade or business (that is, deductions would be allowable under section 162 if other limitations, such as the passive loss rules did not apply),
2) Is conducted in anticipation of starting a trade or business, or
3) Involves research or experimental expenditures that are deductible under section 174 (or would be deductible if you choose 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 property for investment.

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

Rental Activities

A rental activity is a passive activity even if you materially participated (defined later) in that activity unless you meet the qualifications discussed later. See *Special Rules If You Are in a Real Property Trade or Business,* later under *Activities That Are Not Passive Activities.*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 is 7 days or less. The average period of customer use is figured by dividing the total number of days for all rental periods by the number of rentals. If the activity involves renting more than one class of property, multiply the average period of customer use for 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, as figured in (1), is 30 days or less and significant personal services are provided with the rentals. Significant personal services

are only services performed by individuals. The services cannot be excluded services. Excluded services are:

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

b) Services to repair or improve property that would extend its useful life, and

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

3) Extraordinary personal services are provided in connection with customer use. Services are extraordinary personal services if they are performed by individuals, and the use by customers of the property is incidental to their receipt of such 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, and

c) Your gross rental income from the property is less than 2% of the smaller of its unadjusted basis or fair market value.

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 of your partnership, S corporation, or a joint venture.

If you meet any of the exceptions listed above and the activity is a trade or business activity (defined earlier) in which you materially participated (defined later), report any income or loss from the activity on the forms or schedules you normally use.

Rental real estate activities. Individuals can deduct losses from rental real estate activities (in which they actively participated) from up to $25,000 of nonpassive income. Similarly, they can offset credits from such activities against tax on up to $25,000 of nonpassive income after taking into account any losses allowed under this exception.

The $25,000 offset generally phases out at the rate of $0.50 for each dollar by which adjusted gross income, computed with certain modifications, exceeds $100,000. Therefore, taxpayers with modified adjusted gross incomes of $150,000 or more generally cannot use this special allowance. If you are married, filing a separate return, and lived apart from your spouse for the entire tax year, your offset amount cannot exceed $12,500. However, if you lived with your spouse at any time during the year and are filing a separate return, you cannot use this special offset to reduce your nonpassive income or tax on nonpassive income.

Example. Kate, a single taxpayer, has $70,000 in wages, $15,000 income from a limited partnership, and a $26,000 loss from rental real estate activities in which she actively participated, and less than $100,000 of modified adjusted gross income. She can reduce her $26,000 loss by her $15,000 passive income. Because she actively participated in her rental real estate activities, the remaining $11,000 rental real estate loss can be used to offset her $70,000 in wages.

Active participation. Active participation is not the same as material participation, defined later. Active participation is less stringent 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 are relevant for "active participation" include approving new tenants, deciding on rental terms, approving expenditures, and similar decisions. Future regulations will define "active participation."

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 requirements for the activity for the tax year the decedent died.

Unless future regulations provide an exception, limited partners cannot actively participate in rental real estate activities.

You do not actively participate 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 low-income housing and rehabilitation investment credits from rental real estate activities.

Example. Mike, a bachelor, 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 either 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.

Phase-out rule. This special $25,000 ($12,500 for married individuals filing separate returns and living apart at all times during the year) offset for rental real estate in which you actively participate is reduced by 50% of the amount that your modified adjusted gross income exceeds $100,000 ($50,000 for married individuals filing separate returns and living apart at all times during the year).

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

1) Taxable social security and railroad retirement payments,

2) Deductible contributions to individual retirement accounts (IRAs) and retirement plans described in section 501(c)(18),

3) The exclusion of income from United States savings bonds used to pay higher education tuition and fees,

4) Any passive activity loss, or any real property rental loss in which you met the qualifications discussed later under *Special Rules If You Are in a Real Property Trade or Business,* or

5) The deduction for half the self-employment tax.

Example. During 1994, John was unmarried and did not meet the qualifications discussed later under *Special Rules If You Are in a Real Property Trade or Business.* For 1994, he had $120,000 in salary, and a $31,000 loss from his rental real estate activities in which he actively participated and had acquired on November 30, 1993. He had no self-employment earnings. He had no social security or railroad retirement benefits, nor did he make contributions to an IRA or exclude interest from U.S. savings bonds used to pay education expenses. When he files his 1994 return, he may deduct only $15,000 of his passive activity loss. He must carry over the remaining $16,000 passive activity loss to 1995. His deduction and carryover are computed as follows:

Adjusted gross income, modified as required	$120,000
Minus amount not subject to phase-out	100,000
Amount subject to phase-out rule	$ 20,000
Multiply by applicable percentage	×50%
Required reduction to APRRE* offset amount	$ 10,000
Maximum offset	$ 25,000
Less required reduction (see above)	10,000
Adjusted offset amount for APRRE* activities	$ 15,000
Passive loss from rental real estate	$ 31,000
Deduction allowable/ Adjusted offset amount (see above)	15,000
Amount that must be carried forward	$ 16,000

*Active Participation Rental Real Estate

Note. A higher phase-out range applies to low-income housing credits for property placed in service before 1990, and rehabilitation investment credits from rental real estate activities. For those credits, the phase-out of the $25,000 offset 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 phase-out of the $25,000 offset for low-income housing property placed in service after 1989. If you held an indirect interest in the property through a partnership, S corporation, or other pass-through entity, this special exception will not apply unless you also acquired your interest in the pass-through entity after 1989.

The $25,000 offset is applied first to passive activity losses, then to credits from rental real estate activities with active participation, then to credits for rehabilitation investment credits from rental real estate activities and low-income housing credits for property placed in service before 1990, and then any remaining offset is applied to low-income housing credits for property placed in service after 1989.

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. Your working interest must be held directly or through an entity that does not limit your liability (such as a general partner interest in a partnership). If this is the case, 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), some of your income and losses 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 you used as a residence if section 280A(c)(5) applies. This section applies if you rented out a dwelling, which you also used as your home during the year, for a period 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) Low-income housing activities. Transitional relief is provided for investors in qualified low-income housing activities. Losses from certain investments in low-income housing after 1983 are not treated as losses from a passive activity for a period of up to 7 years from the date of the original investment. See *Low-Income Housing Transition Rules*, later.
6) Real property rental activities in which you materially participated and met certain other qualifications. See *Special Rules If You Are in a Real Property Trade or Business,* later.

Income and losses from these activities should not be entered on Form 8582, but on the forms or schedules you would normally use. However, these activities may be subject to limits other than the passive loss rules.

Material Participation

A trade or business activity is not a passive activity if you materially participate in the activity. You materially participate in a trade or business activity for a tax year if you satisfy one of the following tests.

1) You participated in the activity for more than 500 hours.
2) Your participation is substantially all of 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,* later.
5) You materially participated in the activity for any 5 (whether or not consecutive) of the 10 preceding tax years. When determining whether you materially participated in tax years beginning before 1987 (other than a tax year of a partnership, S corporation, estate, or trust ending after 1986), you materially participated only if you participated for more than 500 hours during the tax year.
6) The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years. To determine material participation in tax years beginning before 1987 (other than a tax year of a partnership, S corporation, estate, or trust ending after 1986), you materially participated only if you participated for more than 500 hours during the tax year. Personal services are defined earlier.
7) Based on all the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis.

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:

1) Any person other than you received compensation for managing the activity, or
2) 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 when you perform the work is treated as participation in the activity.

Work not usually performed by owners. Work you do in connection with an activity is not treated as participation in the activity if:

1) The work is not the type of work that is customarily done by the owner of that activity, and
2) 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 loss rules.

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

1) Studying and reviewing financial statements or reports on operations of the activity,
2) Preparing or compiling summaries or analyses of the finances or operations of the activity for your own use, and
3) Monitoring the finances or operations of the activity in a non-managerial capacity.

Spouse's participation. If you are married for the tax year, 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.

Proof of participation. You can use any reasonable method to prove your participation in an activity for the year. You do not have to maintain contemporaneous daily time reports, logs, or similar documents if you can establish your participation 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 did not materially participate in the activity. However, you did materially participate in the activity if you materially participated for the tax year under Test (1), (5), or (6).

You are not treated as a limited partner, however, if you 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 farmer. If you are a retired or disabled farmer, you are treated as materially participating in a farming activity if you materially participated 5 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 ***qualifying business requirements*** for exclusion from the at-risk limits, discussed later under *Special exception for qualified corporations.*

Losses from passive activities of closely held corporations. A closely held corporation can also offset ***net active income*** with its passive activity loss. It can offset the tax attributable to net active income with its passive activity credits. However, a closely held corporation cannot offset portfolio income (defined later under *Nonpassive Income*) with its passive activity loss.

Net active income is the corporation's taxable income figured without any income or loss from a passive activity or any portfolio income or loss.

Low-Income Housing Transition Rules

Any loss you have as a qualified investor in a qualified low-income housing project for any tax year in the relief period (defined later) is **not** treated as a passive activity loss.

Qualified investor. In general, a qualified investor is an individual who:

1) Owns an interest (or had a binding contract to acquire one) in a qualified low-income housing project on August 16, 1986 (on December 31, 1986, if the project was placed in service after August 16, 1986), and the initial investment was made after December 31, 1983, and
2) Is required to make payments after 1986 of 50% or more of the total original obligated investment.

A partner who owns a partnership interest on December 31, 1988, may be treated as a qualified investor if:

1) Any qualified low-income housing property was held by the partnership and placed in service on or after December 31, 1985, and before August 17, 1986,
2) The property is held until the end of the tax year at issue, and
3) The partnership is not treated as a new partnership or terminated at any time after the property was placed in service.

If a decedent was treated as a qualified investor, the estate will retain the same tax treatment that the decedent was entitled to for the estate's first 2 tax years ending after the decedent's death.

Qualified low-income housing project. A project is a qualified low-income housing project if it meets all of the following requirements.

1) It meets the requirements of clause i, ii, iii, or iv of Internal Revenue Code section 1250 (a)(1)(B) as of the date placed in service and for each tax year beginning after 1986 for which a passive loss may be allowable for the project.
2) Its operator certifies to the IRS that the project met the requirements in (1) on October 22, 1986 (or when placed in service, if later), and each year thereafter.
3) It is constructed or acquired under a written contract signed before August 17, 1986.
4) It was placed in service before 1989.

Relief period. The relief period begins with the tax year in which you make the initial investment and ends with the earliest of:

1) The sixth tax year after the tax year in which you made the initial investment,
2) The first tax year after the tax year in which you are obligated to make the last investment, or
3) The tax year before the first tax year for which the project ceases to be a qualified low-income housing project.

Special Rules If You Are in a Real Property Trade or Business

Generally, rental activities are passive activities even if you materially participate. However, beginning in 1994, if you meet the qualifications listed below, rental real estate activities in which you materially participate are not subject to the passive activity limits.

Qualifications. You must use the rules for this section and treat a rental real estate activity like any nonrental activity if the personal services you performed in ***real property trades or businesses*** in which you materially participated are:

1) More than half of the personal services you performed in all trades or businesses during the year, and
2) More than 750 hours.

If you file a joint return, you qualify only if you or your spouse separately satisfies the preceding requirements. However, you can count your spouse's participation in an activity in determining if you materially participate. Material participation was discussed earlier.

Real property trades or businesses. A real property trade or business is a trade or business that:

- Develops,
- Redevelops,
- Constructs,
- Reconstructs,
- Acquires,
- Converts,
- Rents,
- Operates,
- Manages,
- Leases, or
- Brokers

real property.

Services as an employee. If you own:

Or are considered to own more than 5% of your employer's outstanding stock or more than 5% of your employer's voting stock, or

More than 5% of the capital or profits interest of your employer,

then real property trade or business services that you performed as an employee can be treated as personal services that you performed for purposes of the ***qualifications*** discussed above. Otherwise, personal services performed as an employee **can not be treated** as performed in real property trades or businesses for purposes of the ***qualifications.***

Closely held corporations. A closely held corporation (other than an S corporation) can qualify if more than 50% of the gross receipts for its tax year come from real property trades or businesses in which it materially participates.

Nonpassive Income

Losses from passive activities can offset only income from passive activities. Income from passive activities does not include income such as:

1) Income from an activity that is not a passive activity. These activities are discussed earlier under *Activities That Are Not Passive Activities.*
2) Gain from the disposition of substantially appreciated property (FMV exceeds 120% of adjusted basis) that had been used in a nonpassive activity. However, the gain is passive income if the property was used in a passive activity for either (1) 20% of the time you held the property or (2) the entire 24-month period ending on the disposition date. The disposition date is the date you agree to transfer your interest for a fixed or determinable amount.
3) Portfolio income. This includes interest, dividends, annuities, and royalties not derived in the ordinary course of a trade or

business. Also, gain or loss from the disposition of property that produces these types of income or that is held for investment is not passive income. The interest from loans between partnerships and their partners or S corporations and their shareholders is considered ''self-charged.'' Some self-charged interest income may be recharacterized as passive income.

4) 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.
5) 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.
6) Income or gain from investments of working capital.
7) 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 earlier in item (2) under *Activities That Are Not Passive Activities.* 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.
8) Any income from intangible property if your personal efforts significantly contributed to the creation of the property.
9) Income from a qualified low-income housing project for any year in the relief period in which losses from the project would not be subject to the passive loss limitations under the special transitional rule for certain low-income housing projects. See *Low-Income Housing Transition Rules,* earlier.
10) Any other income that must be treated as nonpassive income. See *Recharacterization of Passive Income,* later.
11) Income from any interest in a publicly traded partnership. See *Publicly Traded Partnerships (PTPs)* in the Instructions for Form 8582.
12) State, local, and foreign income tax refunds.
13) Income from a covenant not to compete.
14) Income attributable to the reimbursement of a loss from a casualty or theft if the income is included in gross income and the loss deduction is not a passive activity deduction. See Temporary Regulations section 1.469-2T(d)(2) for information on nonpassive activity deductions.
15) Alaska Permanent Fund Dividends.
16) Cancellation of debt income if at the time the debt is discharged the income is not allocated to passive activity expenditures. The income is generally allocated in the same manner as the debt is allocated for the interest expense allocation rules. See Chapter 8 of Publication 535, *Business Expenses*, for information on the rules for allocating interest.

Currently reportable gains (from installment sales that occurred before 1987) are passive income, if the activity would have been treated as a passive activity had the passive activity rules been in effect before 1987.

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 nondepreciable property,

Equity-financed lending activities,

Rental of property incidental to development activities,

Property rented to nonpassive activities, and

Licensing intangible property by passthrough 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 or property 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 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 the worksheets. Instead, enter income or losses on the form and schedules you normally use. See *Treatment of net income,* later.

Significant participation passive activities. If your passive activity gross income from significant participation passive activities exceeds your passive activity deductions from those activities, a ratable portion of your net income from each significant participation passive activity is treated as nonpassive income. See *Significant Participation Passive Activities,* later. A significant participation passive activity is any trade or business activity (defined earlier) in which you participated for more than 100 hours during the tax year and did not materially participate. See *Material Participation,* 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 under section 167 of the Internal Revenue Code, the net passive income is treated as nonpassive income.

If you have an overall loss (including prior year unallowed losses) from this rental activity, the overall loss is treated as any other passive activity loss. Use Worksheet 1, Form 8582, if you qualify for active participation in the activity or Worksheet 2 if you do not qualify for active participation.

Example. Calvin acquires vacant land for $300,000, constructs improvements at a cost of $100,000 and leases 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 percent of the unadjusted basis of all property ($400,000) used in the rental activity. Therefore, an amount of Calvin's gross income from the activity equal to net passive income from the activity (which is figured with the gain from the disposition, including gain from the improvements) is not treated as though from a passive activity.

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

1) You recognize gain from the sale, exchange, or other disposition of the rental property during the tax year.
2) You started to rent the item of property less than 12 months before the date of disposition.
3) 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).

Property rented 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 just described under *Rental of property incidental to a development activity*.

Licensing of intangible property by passthrough entities. Net royalty income from intangible property held by a passthrough entity in which you own an interest may be

Worksheet A. **Significant Participation Passive Activities**

Name of Activity	(a) Hours of Participation	(b) Net loss	(c) Net income	(d) Combine cols. (b) and (c)
Totals				

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 the entity reasonably incurred in developing or marketing the property exceed 50% of the gross royalties from licensing the property that are includable in your gross income for the tax year, or

2) Your share of the expenses the entity reasonably incurred 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.

Limitation on recharacterized passive income. The total gross income that is treated as nonpassive income under the rules described earlier for *Significant participation passive activities, Rental of nondepreciable property,* or *Equity-financed lending activities* cannot exceed the greatest amount of gross income that is treated as nonpassive income under any one of these rules.

Treatment of net income. If any of the activities listed under the *Recharacterization of Passive Income* rules had net income that is nonpassive, do not enter any income or loss from the activity on Form 8582. The net income and losses are reported on the form or schedule that you normally use. However, if you must complete Form 8582 because you have other passive activities, see the discussion of the worksheets under *Significant Participation Passive Activities*, later.

Investment income and investment expense. To compute your investment interest expense limitation on Form 4952, *Investment Interest Expense Deduction,* treat as investment income any net passive income recharacterized as nonpassive income from rental of nondepreciable property, an equity-financed lending activity, or the licensing of intangible property by a passthrough 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. See *Material Participation,* earlier.

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.

Worksheet A

Complete Worksheet A if you have income or losses from any trade or business activity in which you participated for more than 100 hours during the tax year but did not otherwise meet any of the material participation tests.

Enter the names of the activities in the left-hand column.

Column (a). Enter the number of hours you participated in each activity and total the column. If the total exceeds 500, do not complete Worksheet A. Report all the income and losses from these activities on the forms and schedules you normally use. Do not use Form 8582 and skip Worksheet B.

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

1) The activity's current year net loss (if any) plus prior year unallowed losses (if any), or

2) The excess of prior year unallowed losses over the current year net income (if any). Also, 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.

Note. The prior year unallowed loss from an activity is the unallowed loss from column (c) of Worksheet 4 in your 1993 Form 8582 Instructions.

Column (d). Combine amounts in the Totals row for columns (b) and (c) and enter the net income or net loss in column (d). If the total for column (d) is a net loss and the total hours in column (a) do not exceed 500, skip Worksheet B. Include the income and losses in Worksheet 2 of Form 8582.

If the total for column (d) is net income, the total hours in column (a) do not exceed 500, and you must complete Form 8582 because you have other passive activities to report, complete Worksheet B. However, you do not have to complete Form 8582 if column (d) is net income, the total hours in column (a) do not exceed 500, and you have no passive activities that are not significant participation activities. If you do not have to complete Form 8582, skip Worksheet B. Report the net income and net losses from columns (b) and (c) on the forms and schedules you normally use.

Worksheet B

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.

Worksheet B. **Significant Participation Activities—**(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		1.00		

Column (b). Divide each of the individual net income amounts in column (a) by the total of column (a). Enter the ratio for each of the activities in column (b). The total of the ratios should equal 1.00.

Column (c). Multiply the total 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, if any, that current year net income was reduced by prior year unallowed losses. Enter the result in column (d). This column shows the recomputed current year passive net income for significant participation passive activities that had some of its income recharacterized as nonpassive income.

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 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. Furthermore, the person acquiring the interest from you must not be related to you.

Note. If you have a capital loss on the disposition of an interest in a passive activity, the loss may be limited by the capital loss rules. The limit is generally $3,000 for individuals. See Publication 544, *Sales and Other Dispositions of Assets,* for more information.

Treatment of excess losses. If all gain or loss realized on the disposition is recognized, the excess of:

1) The sum of:
   a) Any loss from the activity for the tax year (including losses carried over from prior years), plus
   b) Any loss realized on the disposition,

over

2) Net income or gain for the tax year from all passive activities (other than the activity disposed of),

will not be treated as a loss from a passive activity.

Example. Ray earned a $60,000 salary and owned one passive activity through a 5% interest in the B Limited Partnership. He sold his entire interest in the current tax year to an unrelated person for $50,000. His adjusted basis in the partnership interest was $42,000, and he had carried over $2,000 of passive activity losses from the activity. He realized an $8,000 gain from the sale but can offset it by the $2,000 carryover loss. This offset occurs under the general passive loss rules without applying the special rules for dispositions. His $6,000 net gain is computed as follows:

Sales price	$50,000
Minus: adjusted basis	42,000
Gain	$ 8,000
Minus: carryover losses allowable	2,000
Net gain	$ 6,000

If Ray sold his interest for $30,000, instead of $50,000, his deductible loss would be $5,000, computed as follows:

Sales price	$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 the current tax year. He must carry over the $9,000 capital loss, which is not subject to the passive activity loss limit. He will treat it as 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, losses are allowed each year in the ratio of the gain recognized in the tax year to the gain remaining to be recognized at the beginning of the year.

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. A partnership interest or S corporation stock is **not** considered property used in an activity. Activities in a partnership or S corporation are reported to and passed through to the partners and shareholders. See *Activities conducted through partnerships or S corporations*, earlier. Such partner or shareholder must dispose of their entire interest in an **activity** to deduct their unallowed losses in the current year.

Dispositions by gift. If you give away any interest in a passive activity, the accumulated 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 any such losses allocable to the interest for which a deduction has not been allowed.

Dispositions by death. If a passive activity interest is transferred because the owner dies, accumulated unused losses are allowed (to a certain extent) as a deduction against the decedent's income in the year of disposition. 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).

How To Report Your Passive Activity Loss

Reporting your passive activities may require more than one form or schedule. 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 A (Form 1040), *Itemized Deductions,*

- 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 8582, *Passive Activity Loss Limitations,* and
- Form 8582–CR, *Passive Activity Credit Limitations.*

Regardless of the number or complexity of passive activities you have, you should use only one Form 8582.

The following example shows how to report your passive activities. In this example, in addition to Form 1040, the taxpayers (Charles and Lily) use Form 8582 (to figure allowed passive activity deductions), Schedule E (to report rental activities and partnership activities), Form 4797 (to figure the gain and allowable loss from assets sold that were used in the activities), and Schedule D (to report the sale of partnership interests).

No matter how many activities you have, you should report each activity on the form you would use if the activity were not passive. Fill out Form 8582 to determine if the passive loss rules disallow any of your losses. Fill out Schedule E, as far as you can, for your rental activities. Use Form 4797 to show gains and losses from the sale of business assets. The Instructions for Form 8582 explain how to use the other forms with Form 8582.

General Information

Charles and Lily are married, file a joint return, and have combined wages of $132,000 in 1994. They own interests in the following activities. They are at risk for all of their investment in the activities. They did not materially participate in any of the business activities. They actively participated in the rental real estate activities in 1994 and all prior years. Charles and Lily were not qualifying taxpayers in a real property business.

1) Activity A is a rental real estate activity. Its income and expenses are reported on Schedule E. Charles and Lily's records show a loss from operations of $15,000 in 1994. Their records also show a gain of $2,776 in 1994 from the sale of section 1231 assets used in the activity. That section 1231 gain is reported in Part I of Form 4797. In 1993, they completed the Worksheets in the Instructions for Form 8582 and calculated that $6,667 of Activity A's Schedule E loss for 1993 was disallowed by the passive loss rules. That loss is carried over to 1994 as a prior year unallowed Schedule E loss.

2) Activity B is a rental real estate activity. Its income and expenses are reported on Schedule E. Charles and Lily's records show a loss from operations of $11,600 in 1994. In 1993, they completed the Worksheets in the Instructions for Form 8582 and calculated that $8,225 of Activity B's Schedule E loss for 1993 was disallowed by the passive loss rules. That loss is carried over to 1994 as a prior year unallowed Schedule E loss.

3) Partnership #1 holds a trade or business activity and is not a publicly traded partnership (PTP). (For a discussion of PTPs, see the Instructions for Form 8582.) Partnership #1 reports a $4,000 distributive share of its 1994 profits to Charles and Lily on line 1 of Schedule K-1, Form 1065. They report that profit on Schedule E. In 1993, they completed the Worksheets in the Instructions for Form 8582 and calculated that $2,600 of their distributive share of Partnership #1's 1993 loss was disallowed by the passive loss rules. That loss is carried over to 1994 as a prior year unallowed Schedule E loss.

4) Partnership #2 is a PTP that holds a trade or business activity. In 1994, Charles and Lily disposed of their entire interest in Partnership #2. They do not report that gain on Form 8582 because Partnership #2 is a PTP. They recognize a long-term capital gain of $15,300 ($25,300 selling price less $10,000 adjusted basis), which they report on Schedule D. The partnership reports a $1,200 distributive share of its 1994 losses to them on line 1 of Schedule K-1, Form 1065. They report that loss on Schedule E. In 1993, they completed the PTP Worksheet in the Instructions for Form 8582 and calculated that $2,445 of their distributive share of Partnership #2's 1993 loss was disallowed by the passive loss rules. That loss is carried over and added to the $1,200 Schedule E loss. See the discussion of PTPs in the Instructions for Form 8582.

5) Partnership #3 holds a single trade or business activity and is not a publicly traded partnership. Charles and Lily sold their entire interest in partnership #3 in November 1994. The sale represents a disposition of their entire interest in this activity. They recognize a $4,000 ($15,000 selling price less $11,000 adjusted basis) long-term capital gain, which they report on Schedule D.

   In 1993, they completed the Worksheets in the Form 8582 Instructions and calculated that $3,000 of their distributive share of the partnership's loss for 1993 was disallowed by the passive loss rules. That loss is carried over to 1994 as a prior year unallowed Schedule E loss. Charles and Lily's distributive share of partnership losses for 1994 reported on line 1 of Schedule K-1, Form 1065 is $6,000.

6) Partnership #4 is a limited partnership that holds a trade or business activity. Charles and Lily are limited partners who did not meet any of the material participation tests. Their distributive share of 1994 partnership loss, reported on line 1 of Schedule K-1, Form 1065, is $2,400. In 1993, they completed the Worksheets in the Form 8582 Instructions and calculated that $1,500 of their distributive share of loss for 1993 was disallowed by the passive loss rules. That loss is carried over to 1994 as a prior year unallowed Schedule E loss.

Step One—Completing the Tax Forms Before Figuring the Passive Activity Loss Limits

As far as they can, Charles and Lily complete the forms they usually use to report income or expenses from their activities. They enter their combined wages, $132,000, on Form 1040. They complete line 9 of Schedule D showing long-term capital gains of $15,300 from Partnership #2 and $4,000 from Partnership #3 in column (g). Because Partnership #2 is a PTP, it is not entered on Form 8582. Since the disposition of Partnership #3 represents a disposition of an entire interest in an activity with an overall loss of $5,000, that partnership is also not entered on Form 8582. They combine the PTP $1,200 current year loss with its $2,445 prior year loss, and also combine the Partnership #3 $6,000 current year loss with its $3,000 prior year loss and enter the two combined amounts in column (g) of Schedule E, Part II. They complete Schedule E, Part I, through line 22. Since their rental activities are passive, they must complete Form 8582 to figure the deductible losses to enter on line 23.

They enter the gain from the sale of the section 1231 assets of Activity A on Form 4797. They enter the $4,000 profit from Partnership #1 on Schedule E, Part II.

Step Two—Form 8582 and the Worksheets

Charles and Lily now complete Form 8582 and the worksheets that apply to their passive activities. Because they are at risk for all amounts invested in their activities, they do not complete Form 6198 before Form 8582. (The second part of this publication explains the at-risk rules.)

Worksheet 1

1) Charles and Lily compute the gains and losses on Worksheet 1 for Activity A (a rental real estate activity). They enter all amounts from the activity even though they already reported the gain of $2,776 on Form 4797, since all income or loss from an activity must be taken into account to figure the loss allowed. They write Activity A under Name of activity. Then they enter:
   a) $2,776 gain in column (a) from Form 4797, line 2(h).
   b) ($15,000) loss in column (b) from Schedule E, line 22, column A.
   c) ($6,667) prior year unallowed loss in column (c) from their worksheets used in 1993.
   d) They combine the three amounts.
   e) Since the result ($18,891) is an overall loss, they enter it in column (e).
2) Activity B is a rental activity with a 1994 loss and a prior year unallowed loss.

Charles and Lily write Activity B under Name of activity. Then they enter:

a) ($11,600) loss in column (b) from Schedule E, line 22, column B.

b) ($8,225) prior year unallowed loss in column (c) from their 1993 worksheets.

c) Then they combine these two figures and enter the total loss ($19,825) in column (e).

3) They separately add columns (a), (b), and (c).

a) They enter $2,776 in column (a) on the Total line and also on Form 8582, Part I, line 1a.

b) They enter ($26,600) in column (b) on the Total line and also on Form 8582, Part I, line 1b.

c) They enter ($14,892) in column (c) on the Total line and also on Form 8582, Part I, line 1c.

4) They combine lines 1a, 1b, and 1c, Form 8582, and put the net loss ($38,716) on line 1d.

Worksheet 2. Because Partnership #1 and Partnership #4 are nonrental passive activities, Charles and Lily enter the appropriate information on Worksheet 2 similar to the way they reported their rental activities on Worksheet 1. Then they enter the totals on Form 8582, Part I, lines 2a through 2d.

Reporting Income From Column (d), Worksheets 1 and 2. Activities that have an overall gain in column (d) are not used any further in the calculations for Form 8582. At this point, overall gain activities should be entered on the forms or schedules that would normally be used. They have one activity with an overall gain ($4,000 – $2,600 =$1,400). This is Partnership #1, which is shown in Worksheet 2. They enter this partnership directly on Part II, Schedule E. They write:

1) Partnership #1 on Line C in column (a).
2) ''P'' in column (b) since this entity is a partnership.
3) No entry in (c) since it is not a foreign partnership.
4) The identification number in (d).
5) A check mark in (e) since all of their investment is at risk.
6) ($2,600) in column (g) which is the prior year unallowed Schedule E loss.
7) $4,000 in column (h), their distributive share of 1994 profit.

Step Three—Completing Form 8582

Charles and Lily must now fill out Part II, Form 8582 since they will need the figure on line 9 to complete Worksheet 3. They enter all amounts without brackets as though they were positive. They can then complete Part III of Form 8582.

1) They enter $38,716 on line 4 since this is the smaller of line 1d or line 3.
2) They enter $150,000 on line 5 since they are married and filing a joint return.
3) They enter $138,655, their modified adjusted gross income, on line 6. See the Instructions for Form 8582 for a discussion of modified adjusted gross income. The $138,655 is made up of their wages, $132,000, plus their overall gain, $11,655, from the entire disposition of Partnership #2, a PTP, plus a $5,000 overall loss from the entire disposition of partnership #3.

   They reported on Schedule D long-term gains of $15,300 from the PTP disposition and $4,000 from the partnership #3 disposition. Also, on Schedule E they combined the PTP 1994 loss of $1,200 with its prior year loss of $2,445, and combined the Partnership #3 1994 loss of $6,000 with its prior year loss of $3,000. Netting these amounts gives them the PTP overall gain of $11,655 and the Partnership #3 overall loss of $5,000 that were used in figuring modified adjusted gross income.
4) They subtract line 6 from line 5 and enter the result, $11,345, on line 7.
5) They multiply line 7 by 50% and enter the result, $5,673, on line 8. No matter what the result, they cannot enter more than $25,000 on line 8.
6) They enter the smaller of line 4 or line 8 on line 9, or $5,673.
7) They add the income on lines 1a and 2a and enter the result, $6,776, on line 10.
8) They add lines 9 and 10 and enter the result, $12,449, on line 11.

Step Four—Completing Worksheet 3

Charles and Lily must complete Worksheet 3 since they have an overall loss in column (e) of Worksheet 1 and an amount on line 9 of Form 8582.

1) In the two left-hand columns, they write the names of the activities, A and B, and the schedules the activities are reported on, Schedule E.
2) They fill in column (a) with the losses from Worksheet 1, column (e). They add up the amounts, and enter the result, $38,716, in the Total line without brackets.
3) They figure the ratios for column (b) by dividing each amount in column (a) by the Total line and entering the result in (b). These ratios, when added, should equal 1.00.
4) Now they are ready to prorate their special allowance for active participation rental real estate activities (from Form 8582, Part II, line 9) among their rental activities. They multiply the amount from line 9, Form 8582, $5,673, by each of the ratios in Worksheet 3, column (b) and enter the results on the appropriate line in column (c). The total should equal $5,673.
5) They subtract column (c) from column (a) and enter each result in column (d).

Step Five—Completing Worksheet 4

You must complete Worksheet 4 if you have an overall loss in column (e) of Worksheet 2 or losses in column (d) of Worksheet 3 (or column (e) of Worksheet 1 if you did not have to complete Worksheet 3). Charles and Lily fill out Worksheet 4 with the activities from Worksheet 3. They have one activity showing a loss in Worksheet 2, column (e). They fill in the names of the activities and the schedules or forms each will be reported on in the two left-hand columns of Worksheet 4.

1) In column (a), they enter the losses from Worksheet 2, column (e) and Worksheet 3, column (d). These losses are entered as positive numbers, not in brackets. They add the numbers and enter the total, $36,943, on the Total line.
2) They divide each of the losses in column (a) by the amount on the column (a) Total line, and enter each result in column (b). These numbers should also add up to 1.00.
3) Now they use the computation worksheet for column (c) under Worksheet 4 of the Instructions for Form 8582 to figure the unallowed loss to allocate in column (c).

a) On line A of the computation worksheet, they enter the amount from line 3 of Form 8582, $41,216, as a positive number.

b) On line B, they enter the amount from line 9 of Form 8582, $5,673.

c) They subtract line B from line A and enter the result, $35,543, on line C.

d) They multiply line C, $35,543, by each of the ratios in column (b) and enter the results in column (c). This is their total unallowed loss for 1994.

Step Six—Using Worksheets 5 and 6

Charles and Lily now decide whether they must use Worksheet 5, Worksheet 6, or both to figure their allowed losses. If the losses from each activity entered on Worksheet 4 are reported on only one form or schedule, then Worksheet 5 is used. If any activity has a loss that is reported on two or more schedules or forms (for example, a loss that must be reported partly on Schedule C and partly on Form 4797), Worksheet 6 is used. They must use only Worksheet 5 to figure their allowed losses.

Worksheet 5. Charles and Lily determine that three of the activities they entered on Worksheet 4 should go on Worksheet 5 since the losses are reported on Schedule E only. The activities are A, B, and Partnership #4.

1) They enter the names of the activities and the schedules to be used in the two left-hand columns of Worksheet 5.
2) In column (a), they enter the total loss for each activity. These losses include the

current year loss plus the prior year unallowed loss. They find these amounts by adding columns (b) and (c) on Worksheets 1 and 2.

3) In column (b), they enter the unallowed loss for each activity already figured in Worksheet 4, column (c). They must save this information to use next year in figuring their passive losses.

4) In column (c), they figure their allowed losses for 1994 by subtracting their unallowed losses, column (b), from their total losses, column (a). These allowed losses are entered on the appropriate schedules. They enter their allowed losses from Activities A and B on Schedule E, Part I, line 23, because these are rental properties. They report their allowed loss from Partnership #4 on Schedule E, Part II by writing:

   a) The name of the activity on line 27D, column (a),

   b) ''P'' in column (b),

   c) The employer identification number in column (d),

   d) A check mark in column (e) since all their investment is at-risk, and

   e) ($148) in column (g).

Step Seven—Finishing the Reporting of the Passive Activities

Charles and Lily summarize the entries on Schedule E, Schedule D, and Form 4797, and enter the amounts on the appropriate lines of their Form 1040. They enter:

1) The total Schedule D gain, $22,076, on line 13.

2) Schedule E loss ($21,094) on line 17.

Charles and Lily are now able to complete their return, having limited their losses from their passive activities as required.

At-Risk Limits

The at-risk rules limit your losses from most activities to your loss or amount at risk, whichever is less. The at-risk rules ***must be applied before*** the passive activity rules discussed in the first part of this publication. Also, see *Loss limits for partners and S corporation shareholders,* later.

Amount at risk. 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.

''Amount at risk'' is discussed under *At-Risk Amounts,* later.

Taxpayers affected. The at-risk limits apply to individuals and to certain closely held corporations (other than S corporations).

Closely held corporation. For the at-risk rules, a 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 rules (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).

Loss defined. A loss is the excess of allowable deductions from the activity for the year (including depreciation or amortization allowed or allowable, disregarding the at-risk limits) over income received or accrued from that activity during the year. Income does not include income from the recapture of previous losses (discussed later under *Reductions of Amounts At Risk*) that is required because the amount at risk was less than zero.

Disallowed losses. Any loss from an activity that is not allowed in a tax year because of the at-risk limits is treated as a deduction for the activity in the next tax year.

Form 6198. Form 6198, *At-Risk Limitations,* is used to figure how much loss from an activity you can deduct. You must file Form 6198 with your tax return if:

1) You have a loss from any part of an activity that is covered by the at-risk rules, and

2) You are not at risk for some of your investment in the activity.

Loss limits for partners and S corporation shareholders. Three separate limits apply to a partner's or shareholder's distributive share of a loss from a partnership or S corporation. The limits determine the amount of the loss each partner or shareholder can deduct on its 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 at-risk rules, and

3) The passive loss rules.

See *Losses* in Publication 541, *Tax Information on Partnerships,* and *Limits on Shareholder's Losses and Deductions* in Publication 589, *Tax Information on S Corporations.*

Activities Covered by the At-Risk Rules

If you are involved in one of the following activities, you are subject to the at-risk rules.

1) Farming.

2) Exploring for, or exploiting, oil and gas as a trade or business or for the production of income.

3) Holding, producing, or distributing motion picture films or video tapes.

4) Equipment leasing, that is, leasing section 1245 property, including personal property, and certain other tangible property which is depreciable or amortizable. See *Equipment leasing,* later.

5) Exploring for, or exploiting, geothermal deposits (for wells started after September 1978).

6) Holding real property placed in service after 1986. However, if you are a partner in a partnership, a shareholder in an S corporation, or have an interest in any other passthrough entity that you acquired after 1986, the at-risk rules apply no matter when the entity placed the real property in service.

7) Holding mineral property.

8) Any other activity not included in (1) through (7) that is carried on as a trade or business or for the production of income.

Exclusion 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. Equipment leasing means the leasing, purchasing, servicing, and selling of equipment that is section 1245 property. Section 1245 property is any depreciable or amortizable property that is:

1) Personal property,

2) Other tangible property (other than a building or its structural components) that is:

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return (1) **1994**

IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 1994, or other tax year beginning , 1994, ending , 19 | OMB No. 1545-0074

Label

(See instructions on page 12.)
Use the IRS label. Otherwise, please print or type.

LABEL HERE

Your first name and initial | Last name | Your social security number

CAR-RT-SORT **CR01
CW 123-00-4567 567-00-1234
Charles Eric & Lily Woods
6925 Country Road
Anytown, VA 22306

If a joint return, spouse's first name and initial | Last name | Spouse's social security number

Home address (number and street). | Apt. no.

City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.

For Privacy Act and Paperwork Reduction Act Notice, see page 4.

Presidential Election Campaign (See page 12.)

	Yes	No
Do you want $3 to go to this fund?	✓	
If a joint return, does your spouse want $3 to go to this fund?	✓	

Note: *Checking "Yes" will not change your tax or reduce your refund.*

Filing Status

(See page 12.)

Check only one box.

1 [ ] Single
2 [✓] Married filing joint return (even if only one had income)
3 [ ] Married filing separate return. Enter spouse's social security no. above and full name here. ▶
4 [ ] Head of household (with qualifying person). (See page 13.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 [ ] Qualifying widow(er) with dependent child (year spouse died ▶ 19). (See page 13.)

Exemptions

(See page 13.)

6a [✓] **Yourself.** If your parent (or someone else) can claim you as a dependent on his or her tax return, **do not** check box 6a. But be sure to check the box on line 33b on page 2

b [✓] **Spouse**

No. of boxes checked on 6a and 6b: 2

c **Dependents:**

(1) Name (first, initial, and last name)	(2) Check if under age 1	(3) If age 1 or older, dependent's social security number	(4) Dependent's relationship to you	(5) No. of months lived in your home in 1994

If more than six dependents, see page 14.

No. of your children on 6c who:
- lived with you
- didn't live with you due to divorce or separation (see page 14)

Dependents on 6c not entered above

d If your child didn't live with you but is claimed as your dependent under a pre-1985 agreement, check here ▶ [ ]

e Total number of exemptions claimed

Add numbers entered on lines above ▶ 2

Income

Attach Copy B of your Forms W-2, W-2G, and 1099-R here.

If you did not get a W-2, see page 15.

Enclose, but do not attach, any payment with your return.

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	132,000
8a	**Taxable** interest income (see page 15). Attach Schedule B if over $400	8a	
b	**Tax-exempt** interest (see page 16). DON'T include on line 8a — 8b		
9	Dividend income. Attach Schedule B if over $400	9	
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 16)	10	
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	
13	Capital gain or (loss). If required, attach Schedule D (see page 16)	13	22,076
14	Other gains or (losses). Attach Form 4797	14	
15a	Total IRA distributions — 15a — b Taxable amount (see page 17)	15b	
16a	Total pensions and annuities — 16a — b Taxable amount (see page 17)	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	<21,094>
18	Farm income or (loss). Attach Schedule F	18	
19	Unemployment compensation (see page 18)	19	
20a	Social security benefits — 20a — b Taxable amount (see page 18)	20b	
21	Other income. List type and amount—see page 18	21	
22	Add the amounts in the far right column for lines 7 through 21. This is your **total income** ▶	22	132,982

Adjustments to Income

Caution: See instructions ▶

23a	Your IRA deduction (see page 19)	23a	
b	Spouse's IRA deduction (see page 19)	23b	
24	Moving expenses. Attach Form 3903 or 3903-F	24	
25	One-half of self-employment tax	25	
26	Self-employed health insurance deduction (see page 21)	26	
27	Keogh retirement plan and self-employed SEP deduction	27	
28	Penalty on early withdrawal of savings	28	
29	Alimony paid. Recipient's SSN ▶	29	
30	Add lines 23a through 29. These are your **total adjustments** ▶	30	

Adjusted Gross Income

31	Subtract line 30 from line 22. This is your **adjusted gross income**. If less than $25,296 and a child lived with you (less than $9,000 if a child didn't live with you), see "Earned Income Credit" on page 27 ▶	31	132,982

Cat. No. 11320B

SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service (T)

Capital Gains and Losses

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).

▶ Use lines 20 and 22 for more space to list transactions for lines 1 and 9.

OMB No. 1545-0074

1994

Attachment Sequence No. 12

Name(s) shown on Form 1040: Charles Eric and Lily Woods

Your social security number: 123 00 4567

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-3)	(e) Cost or other basis (see page D-3)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
1							
2	Enter your short-term totals, if any, from line 21	2					
3	**Total short-term sales price amounts.** Add column (d) of lines 1 and 2 . . .	3					
4	Short-term gain from Forms 2119 and 6252, and short-term gain or (loss) from Forms 4684, 6781, and 8824				4		
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				5		
6	Short-term capital loss carryover. Enter the amount, if any, from line 9 of your 1993 Capital Loss Carryover Worksheet				6		
7	Add lines 1, 2, and 4 through 6, in columns (f) and (g).				7	( )	
8	**Net short-term capital gain or (loss).** Combine columns (f) and (g) of line 7 . . . . . . ▶					8	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

	(a) Description of property	(b) Date acquired	(c) Date sold	(d) Sales price	(e) Cost or other basis	(f) LOSS	(g) GAIN
9	Partnership # 2 (entire disposition of passive activity)	12 01 91	12 02 94	25,300	10,000		15,300
	Partnership # 3 (entire disposition of passive activity)	12 15 92	11 16 94	15,000	11,000		4,000
10	Enter your long-term totals, if any, from line 23	10					
11	**Total long-term sales price amounts.** Add column (d) of lines 9 and 10 . . .	11		40,300			
12	Gain from Form 4797; long-term gain from Forms 2119, 2439, and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824				12		2,776
13	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				13		
14	Capital gain distributions				14		
15	Long-term capital loss carryover. Enter the amount, if any, from line 14 of your 1993 Capital Loss Carryover Worksheet				15		
16	Add lines 9, 10, and 12 through 15, in columns (f) and (g)				16	( )	22,076
17	**Net long-term capital gain or (loss).** Combine columns (f) and (g) of line 16 . . . . . . ▶					17	22,076

Part III Summary of Parts I and II

18	Combine lines 8 and 17. If a loss, go to line 19. If a gain, enter the gain on Form 1040, line 13. **Note:** *If both lines 17 and 18 are gains, see the* ***Capital Gain Tax Worksheet*** *on page 25* . .	18	22,076
19	If line 18 is a (loss), enter here and as a (loss) on Form 1040, line 13, the **smaller** of these losses:		
a	The (loss) on line 18; or		
b	($3,000) or, if married filing separately, ($1,500)	19	( )
	Note: *See the* ***Capital Loss Carryover Worksheet*** *on page D-3 if the loss on line 18 exceeds the loss on line 19* ***or*** *if Form 1040, line 35, is a loss.*		

SCHEDULE E (Form 1040)

Department of the Treasury Internal Revenue Service (T)

Supplemental Income and Loss

(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)

▶ Attach to Form 1040 or Form 1041. ▶ See Instructions for Schedule E (Form 1040).

OMB No. 1545-0074

1994

Attachment Sequence No. 13

Name(s) shown on return: Charles Eric and Lily Woods

Your social security number: 123 00 4567

Part I **Income or Loss From Rental Real Estate and Royalties** **Note:** *Report income and expenses from your business of renting personal property on* **Schedule C** *or* **C-EZ** *(see page E-1). Report farm rental income or loss from* **Form 4835** *on page 2, line 39.*

1	Show the kind and location of each rental real estate property:
A	Brick duplex - 6924-26 Country Road Anytown, VA 22306
B	Condo - 6915 Country Road Anytown, VA 22306
C	

2 For each rental real estate property listed on line 1, did you or your family use it for personal purposes for more than the greater of 14 days or 10% of the total days rented at fair rental value during the tax year? (See page E-1.)

	Yes	No
A		✓
B		✓
C		

Income:		Properties A	Properties B	Properties C		Totals (Add columns A, B, and C.)
3 Rents received	3	25,000	8,300		3	33,300
4 Royalties received	4				4	
Expenses:						
5 Advertising	5	600	210			
6 Auto and travel (see page E-2)	6					
7 Cleaning and maintenance	7	1,500	525			
8 Commissions	8	1,200	420			
9 Insurance	9	2,000	700			
10 Legal and other professional fees	10	1,000	390			
11 Management fees	11					
12 Mortgage interest paid to banks, etc. (see page E-2)	12	9,000	8,510		12	17,510
13 Other interest	13					
14 Repairs	14	700	245			
15 Supplies	15	600	210			
16 Taxes	16	2,000	700			
17 Utilities	17	2,400	840			
18 Other (list) ▶ Wages and salaries	18	9,000	3,150			
19 Add lines 5 through 18	19	30,000	15,900		19	45,900
20 Depreciation expense or depletion (see page E-2)	20	10,000	4,000		20	14,000
21 Total expenses. Add lines 19 and 20	21	40,000	19,900			
22 Income or (loss) from rental real estate or royalty properties. Subtract line 21 from line 3 (rents) or line 4 (royalties). If the result is a (loss), see page E-2 to find out if you must file **Form 6198**	22	<15,000>	<11,600>			
23 Deductible rental real estate loss. **Caution:** *Your rental real estate loss on line 22 may be limited. See page E-3 to find out if you must file* **Form 8582**. *Real estate professionals must complete line 42 on page 2*	23	(6,155)	(3,546)	( )		

24 **Income.** Add positive amounts shown on line 22. **Do not** include any losses	24	
25 **Losses.** Add royalty losses from line 22 and rental real estate losses from line 23. Enter the total losses here	25	(9,701)
26 Total rental real estate and royalty income or (loss). Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 39 on page 2 do not apply to you, also enter this amount on Form 1040, line 17. Otherwise, include this amount in the total on line 40 on page 2	26	<9,701>

Name(s) shown on return. Do not enter name and social security number if shown on other side. | Your social security number

Note: *If you report amounts from farming or fishing on Schedule E, you must enter your gross income from those activities on line 41 below. Real estate professionals must complete line 42 below.*

Part II Income or Loss From Partnerships and S Corporations **Note:** *If you report a loss from an at-risk activity, you MUST check either column (e) or (f) of line 27 to describe your investment in the activity. See page E-4. If you check column (f), you must attach* **Form 6198.**

27	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	Investment At Risk? (e) All is at risk	(f) Some is not at risk
A	Partnership #2	P		10-1672810	✓	
B	Partnership #3	P		10-9876243	✓	
C	Partnership #1	P		10-5566650	✓	
D	Partnership #4	P		10-7435837	✓	
E						

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss from Schedule K-1	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A	PTP (3,645)				
B	(9,000)				
C	(2,600)	4,000			
D	(148)				
E					
28a Totals		4,000			
b Totals	15,393				

29	Add columns (h) and (k) of line 28a	29	4,000
30	Add columns (g), (i), and (j) of line 28b	30	(15,393)
31	Total partnership and S corporation income or (loss). Combine lines 29 and 30. Enter the result here and include in the total on line 40 below	31	(11,393)

Part III Income or Loss From Estates and Trusts

32	(a) Name	(b) Employer identification number
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A				
B				
33a Totals				
b Totals				

34	Add columns (d) and (f) of line 33a	34	
35	Add columns (c) and (e) of line 33b	35	( )
36	Total estate and trust income or (loss). Combine lines 34 and 35. Enter the result here and include in the total on line 40 below	36	

Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder

37	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see page E-4)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b

38	Combine columns (d) and (e) only. Enter the result here and include in the total on line 40 below	38	

Part V Summary

39	Net farm rental income or (loss) from **Form 4835.** Also, complete line 41 below	39	
40	TOTAL income or (loss). Combine lines 26, 31, 36, 38, and 39. Enter the result here and on Form 1040, line 17 ▶	40	(21,094)
41	**Reconciliation of Farming and Fishing Income.** Enter your **gross** farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), line 15b; Schedule K-1 (Form 1120S), line 23; and Schedule K-1 (Form 1041), line 13 (see page E-4)	41	
42	**Reconciliation for Real Estate Professionals.** If you were a real estate professional (see page E-3), enter the net income or (loss) you reported anywhere on Form 1040 from all rental real estate activities in which you materially participated under the passive activity loss rules	42	

Printed on recycled paper

Form **4797**

Department of the Treasury
Internal Revenue Service (T)

Sales of Business Property

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

OMB No. 1545-0184

1994

Attachment Sequence No. **27**

Name(s) shown on return: Charles Eric and Lily Woods

Identifying number: 123-00-4567

1 Enter here the gross proceeds from the sale or exchange of real estate reported to you for 1994 on Form(s) 1099-S (or a substitute statement) that you will be including on line 2, 11, or 22 1

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Property Held More Than 1 Year

(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) LOSS ((f) minus the sum of (d) and (e))	(h) GAIN ((d) plus (e) minus (f))
2 Land from Activity A	01 04 91	01 05 94	6,000		3,224		2,776

		(g)	(h)
3 Gain, if any, from Form 4684, line 39	3		
4 Section 1231 gain from installment sales from Form 6252, line 26 or 37	4		
5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824	5		
6 Gain, if any, from line 34, from other than casualty or theft	6		
7 Add lines 2 through 6 in columns (g) and (h)	7	( )	2,776

8 Combine columns (g) and (h) of line 7. Enter gain or (loss) here, and on the appropriate line as follows: 8 2,776

Partnerships—Enter the gain or (loss) on Form 1065, Schedule K, line 6. Skip lines 9, 10, 12, and 13 below.

S corporations—Report the gain or (loss) following the instructions for Form 1120S, Schedule K, lines 5 and 6. Skip lines 9, 10, 12, and 13 below, unless line 8 is a gain and the S corporation is subject to the capital gains tax.

All others—If line 8 is zero or a loss, enter the amount on line 12 below and skip lines 9 and 10. If line 8 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain as a long-term capital gain on Schedule D and skip lines 9, 10, and 13 below.

9 Nonrecaptured net section 1231 losses from prior years (see instructions) 9

10 Subtract line 9 from line 8. If zero or less, enter -0-. Also enter on the appropriate line as follows (see instructions): 10

S corporations—Enter this amount (if more than zero) on Schedule D (Form 1120S), line 13, and skip lines 12 and 13 below.

All others—If line 10 is zero, enter the amount from line 8 on line 13 below. If line 10 is more than zero, enter the amount from line 9 on line 13 below, and enter the amount from line 10 as a long-term capital gain on Schedule D.

Part II Ordinary Gains and Losses

11 Ordinary gains and losses not included on lines 12 through 18 (include property held 1 year or less):

		(g)	(h)
12 Loss, if any, from line 8	12		
13 Gain, if any, from line 8, or amount from line 9 if applicable	13		
14 Gain, if any, from line 33	14		
15 Net gain or (loss) from Form 4684, lines 31 and 38a	15		
16 Ordinary gain from installment sales from Form 6252, line 25 or 36	16		
17 Ordinary gain or (loss) from like-kind exchanges from Form 8824	17		
18 Recapture of section 179 expense deduction for partners and S corporation shareholders from property dispositions by partnerships and S corporations (see instructions)	18		
19 Add lines 11 through 18 in columns (g) and (h)	19	( )	

20 Combine columns (g) and (h) of line 19. Enter gain or (loss) here, and on the appropriate line as follows: 20

a For all except individual returns: Enter the gain or (loss) from line 20 on the return being filed.

b For individual returns:

(1) If the loss on line 12 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here and on line 22 of Schedule A (Form 1040). Identify as from "Form 4797, line 20b(1)." See instructions . . . . 20b(1)

(2) Redetermine the gain or (loss) on line 20, excluding the loss, if any, on line 20b(1). Enter here and on Form 1040, line 14 . . 20b(2)

Form **8582**

Department of the Treasury
Internal Revenue Service (T)

Passive Activity Loss Limitations

▶ See separate instructions.
▶ Attach to Form 1040 or Form 1041.

OMB No. 1545-1008
1994
Attachment Sequence No. **88**

Name(s) shown on return: Charles Eric and Lily Woods

Identifying number: 123-00-4567

Part I **1994 Passive Activity Loss**

Caution: *See the instructions for Worksheets 1 and 2 on pages 7 and 8 before completing Part I.*

Rental Real Estate Activities With Active Participation (For the definition of active participation see **Active Participation in a Rental Real Estate Activity** on page 3 of the instructions.)

1a Activities with net income (from Worksheet 1, column (a))	1a	2,776		
b Activities with net loss (from Worksheet 1, column (b))	1b	(26,600)		
c Prior year unallowed losses (from Worksheet 1, column (c))	1c	(14,892)		
d Combine lines 1a, 1b, and 1c			1d	<38,716>

All Other Passive Activities

2a Activities with net income (from Worksheet 2, column (a))	2a	4,000		
b Activities with net loss (from Worksheet 2, column (b))	2b	(2,400)		
c Prior year unallowed losses (from Worksheet 2, column (c))	2c	(4,100)		
d Combine lines 2a, 2b, and 2c			2d	<2,500>
3 Combine lines 1d and 2d. If the result is net income or zero, see the instructions for line 3. If this line and line 1d are losses, go to line 4. Otherwise, enter -0- on line 9 and go to line 10			3	<41,216>

Part II **Special Allowance for Rental Real Estate With Active Participation**

Note: *Enter all numbers in Part II as positive amounts. (See instructions on page 8 for examples.)*

4 Enter the **smaller** of the loss on line 1d or the loss on line 3			4	38,716
5 Enter $150,000. If married filing separately, see the instructions	5	150,000		
6 Enter modified adjusted gross income, but not less than zero (see instructions)	6	138,655		
Note: *If line 6 is equal to or greater than line 5, skip lines 7 and 8, enter -0- on line 9, and then go to line 10. Otherwise, go to line 7.*				
7 Subtract line 6 from line 5	7	11,345		
8 Multiply line 7 by 50% (.5). **Do not** enter more than $25,000. If married filing separately, see instructions			8	5,673
9 Enter the **smaller** of line 4 or line 8			9	5,673

Part III **Total Losses Allowed**

10 Add the income, if any, on lines 1a and 2a and enter the total	10	6,776
11 **Total losses allowed from all passive activities for 1994.** Add lines 9 and 10. See the instructions to find out how to report the losses on your tax return	11	12,449

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 63704F Form **8582** (1994)

Caution: *The worksheets are not required to be filed with your tax return and may be detached before filing Form 8582. Keep a copy of the worksheets for your records.*

Worksheet 1—For Form 8582, Lines 1a, 1b, and 1c (See instructions on page 7.)

Name of activity	Current year		Prior year	Overall gain or loss	
	(a) Net income (line 1a)	(b) Net loss (line 1b)	(c) Unallowed loss (line 1c)	(d) Gain	(e) Loss
Activity A	2,776	<15,000>	<6,667>		<18,891>
Activity B		<11,600>	<8,225>		<19,825>
Total. Enter on Form 8582, lines 1a, 1b, and 1c. . . . . ▶	2,776	<26,600>	<14,892>		

Worksheet 2—For Form 8582, Lines 2a, 2b, and 2c (See instructions on page 8.)

Name of activity	Current year		Prior year	Overall gain or loss	
	(a) Net income (line 2a)	(b) Net loss (line 2b)	(c) Unallowed loss (line 2c)	(d) Gain	(e) Loss
Partnership #1	4,000		<2,600>	1,400	
Partnership #4		<2,400>	<1,500>		<3,900>
Total. Enter on Form 8582, lines 2a, 2b, and 2c. . . . . ▶	4,000	<2,400>	<4,100>		

Worksheet 3—Use this worksheet if an amount is shown on Form 8582, line 9 (See instructions on page 8.)

Name of activity	Form or schedule to be reported on	(a) Loss (See instructions.)	(b) Ratio (See instructions.)	(c) Special allowance (See instructions.)	(d) Subtract column (c) from column (a) (See instructions.)
Activity A	Sch. E	18,891	.487938	2,768	16,123
Activity B	Sch. E	19,825	.512062	2,905	16,920
Total . . . . ▶		38,716	1.00	5,673	33,043

Worksheet 4—Allocation of Unallowed Losses (See instructions on page 9.)

Name of activity	Form or schedule to be reported on	(a) Loss (See instructions.)	(b) Ratio (See instructions.)	(c) Unallowed loss (See instructions.)
Activity A	Sch. E	16,123	.436429	15,512
Activity B	Sch. E	16,920	.458003	16,279
Partnership #4	Sch. E	3,900	.105568	3,752
Total . . . . ▶		36,943	1.00	35,543

Worksheet 5—Allowed Losses (See instructions on page 9.)

Name of activity	Form or schedule to be reported on	(a) Loss (See instructions.)	(b) Unallowed loss (See instructions.)	(c) Allowed loss (See instructions.)
Activity A	Sch. E	21,667	15,512	6,155
Activity B	Sch. E	19,825	16,279	3,546
Partnership #4	Sch. E	3,900	3,752	148
Total . . . . ▶		45,392	35,543	9,849

Worksheet 6—Activities With Losses Reported on Two or More Different Forms or Schedules (See instructions on page 9.)

Name of Activity:	(a) (See instr.)	(b) (See instr.)	(c) Ratio (See instr.)	(d) Unallowed loss (See instr.)	(e) Allowed loss (See instr.)
Form or Schedule To Be Reported on:					
1a Net loss plus prior year unallowed loss from form or schedule . ▶					
b Net income from form or schedule . . . . ▶					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . . ▶					
Form or Schedule To Be Reported on:					
1a Net loss plus prior year unallowed loss from form or schedule . ▶					
b Net income from form or schedule . . . . ▶					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . . ▶					
Form or Schedule To Be Reported on:					
1a Net loss plus prior year unallowed loss from form or schedule . ▶					
b Net income from form or schedule . . . . ▶					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . . ▶					
Total . . . . ▶			1.00		

a) Used in manufacturing, production, or extraction, or in furnishing transportation, communications, energy, water, or sewage disposal,

b) A research facility used for the activities in (a), or

c) A bulk storage facility used for the activities in (a),

3) A single purpose agricultural or horticultural structure, or

4) A storage facility (other than a building or its structural components) used for the distribution of petroleum.

However, equipment leasing ***does not include*** leases 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. Thus, 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 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. Thus, 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.

Real property. Holding real property is treated as a separate activity to which the at-risk limits apply after 1986.

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 available, such as furniture and services, when renting a hotel or motel room or a furnished apartment is considered incidental to making real property available as living accommodations.

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.

A ***qualified corporation*** is a closely held corporation, defined earlier under *Taxpayers affected* that is not:

1) A personal holding company,

2) A foreign personal holding company, or

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

Qualifying business requirements. 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 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 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 the corporation's stock.),

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, and

3) The business is not an ***excluded business.*** Generally, an excluded business involves leasing section 1245 equipment, discussed earlier under *Equipment leasing,* 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

Each film or video tape, item of leased section 1245 equipment, farm, oil and gas property, or geothermal property is generally treated as a ***separate activity.***

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

Aggregation of Activities

Activities which are a trade or business or are for the production of income are treated as one activity if:

1) The taxpayer ***actively participates*** in the management of the trade or business, or

2) 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.

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.

Future regulations may provide additional rules for separating or aggregating activities.

Partners and S corporation shareholders. Partners or shareholders may aggregate certain activities their partnership or S corporation engages in. These activities are:

1) Films and video tapes,

2) Farms,

3) Oil and gas properties, and

4) Geothermal properties.

For example, to apply the at-risk rules for 1994, partners and S corporation shareholders can treat all of the partnership's or S corporation's films and video tapes as one activity.

At-Risk Amounts

You are considered at risk in an activity to the extent of your ***cash*** and the adjusted basis of ***other property*** you contribute to the activity. Your at-risk amount also includes your share of partnership net income that you do not withdraw and certain ***amounts borrowed*** for use in that activity. However, if the borrowed amounts are from nonrecourse financing or loss limiting arrangements, see *Amounts Not At Risk,* later.

Borrowed amounts. 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 the property you pledge is directly or indirectly financed by debt that is secured by property you contributed to the activity.

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 only increase your at-risk amount once.

If a corporation borrows from its shareholder, the corporation will be considered at risk for that amount.

Even though 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 (other than as a creditor) or from someone related to such a lender.

You are not considered at risk for your share of any ***nonrecourse*** loan used to finance the activity or to acquire property used in the activity unless the loan is secured by property not used in the activity. If you borrow money to contribute to the activity and the lender's recourse is only to your interest in the activity or to the property used in the activity, the loan is nonrecourse and does not increase your amount at risk.

Related persons. Related persons include:

1) Members of the family, but only brothers and sisters (both whole- and half-blood), spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.),
2) Two corporations that are members of the same controlled group of corporations determined by applying a 10% ownership test,
3) 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,
4) Certain educational or charitable organizations and a person who directly or indirectly controls one of these organizations,
5) A corporation and an individual who owns, directly or indirectly, more than 10% of the value of the outstanding stock of the corporation,
6) 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,
7) The grantor and fiduciary, or the fiduciary and beneficiary, of any trust,
8) A corporation and a partnership if the same persons own over 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,
9) Two S corporations if the same persons own more than 10% in value of the outstanding stock of each corporation,
10) An S corporation and a regular corporation if the same persons own more than 10% in value of the outstanding stock of each corporation,
11) A partnership and a person who owns directly or indirectly more than 10% of the capital or profits of the partnership,
12) Two partnerships, if the same persons directly or indirectly own more than 10% of the capital or profits of each, and
13) Two persons who are engaged in business under common control.

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 (both whole- and half-blood), 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 rules (1), (2), or (3), stock considered owned by a person under rule (1) is treated as actually owned by that person. However, when applying rules (2) or (3), stock considered owned by an individual under those rules is not again treated as owned by that individual to consider another the owner of that stock.

Effect of governmental price support programs. To apply the at-risk rules to farming operations, a governmental target price program (such as provided by the Agriculture and Consumer Protection Act of 1973) or other governmental 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. To apply the at-risk limits, any loss which 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. Thus, 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 which 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. You generally are not considered at risk for amounts protected against loss through nonrecourse financing. Nonrecourse financing is financing for which you are not personally liable. However, this does not apply to ***qualified nonrecourse financing*** secured by real property used in the holding of real property.

Qualified nonrecourse financing is financing for which no one is personally liable for repayment and is:

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

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

A qualified person ***is not:***

1) A person related to you. 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.
2) A person from which the taxpayer acquired the property, or a person related to such a person.
3) 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. Your capital, including any equity capital you have contributed, is not at risk in the activity 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. In livestock feeding operations, some commercial feedlots offer to 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

It is possible for you to place an amount at risk in an activity, deduct losses from the activity until the at-risk amount is reduced to zero, and then, in a later tax year, withdraw the amounts initially placed in the activity. This withdrawal (which could be by direct distributions to you, by converting a recourse debt to a nonrecourse debt, or by initiating a stop loss agreement) would reduce your at-risk amount to less than zero.

General rule. If the amount you have at risk in any activity at the end of any tax year beginning after 1978 is less than zero, you must add (recapture) that negative at-risk amount (but not more than the ***recapture limit,*** discussed next) to your gross income for that tax year as income from that at-risk activity. The amount you include in your gross income is treated as a deduction allocable to that at-risk activity in the next tax year.

Recapture limit. The amount that you include in your gross income cannot be more than the total amount of losses deducted in prior tax years beginning after 1978 for that at-risk activity, reduced by any amounts you previously included in gross income for that activity under this recapture rule.

Transitional rule for recapture of losses. If the amount for which you were at risk in an activity at the end of your last tax year that began before 1979 was less than zero, you apply the preceding rule for the recapture of losses by using the actual negative amount instead of zero. You would then be subject to recapture of allowed loss deductions only to the extent that your at-risk amount drops below your initial negative amount (rather than zero). For example, if your at-risk amount for your tax year ending December 31, 1978, was minus $50, you would recapture losses for 1979 and later years only to the extent that your at-risk amount went below minus $50.

List of Tax Publications for Individuals

General Guides

1 ...... Your Rights as a Taxpayer
17 ..... Your Federal Income Tax
225 .. Farmer's Tax Guide
334 .. Tax Guide for Small Business
509 .. Tax Calendars for 1995
553 .. Highlights of 1994 Tax Changes
910 .. Guide to Free Tax Services (Includes a list of publications)

Specialized Publications

3 ...... Tax Information for Military Personnel (Including Reservists Called to Active Duty)
54 ..... Tax Guide for U.S. Citizens and Resident Aliens Abroad
378 .. Fuel Tax Credits and Refunds
448 .. Federal Estate and Gift Taxes
463 .. Travel, Entertainment, and Gift Expenses
501 .. Exemptions, Standard Deduction, and Filing Information
502 .. Medical and Dental Expenses
503 .. Child and Dependent Care Expenses
504 .. Divorced or Separated Individuals
505 .. Tax Withholding and Estimated Tax
508 .. Educational Expenses
513 .. Tax Information for Visitors to the United States
514 .. Foreign Tax Credit for Individuals
516 .. Tax Information for U.S. Government Civilian Employees Stationed Abroad
517 .. Social Security and Other Information for Members of the Clergy and Religious Workers
519 .. U.S. Tax Guide for Aliens
520 .. Scholarships and Fellowships
521 .. Moving Expenses
523 .. Selling Your Home
524 .. Credit for the Elderly or the Disabled
525 .. Taxable and Nontaxable Income
526 .. Charitable Contributions
527 .. Residential Rental Property
529 .. Miscellaneous Deductions
530 .. Tax Information for First-Time Homeowners
531 .. Reporting Tip Income
533 .. Self-Employment Tax
534 .. Depreciation
537 .. Installment Sales
541 .. Tax Information on Partnerships
544 .. Sales and Other Dispositions of Assets
547 .. Nonbusiness Disasters, Casualties, and Thefts
550 .. Investment Income and Expenses
551 .. Basis of Assets
552 .. Recordkeeping for Individuals
554 .. Tax Information for Older Americans
555 .. Federal Tax Information on Community Property
556 .. Examination of Returns, Appeal Rights, and Claims for Refund
559 .. Survivors, Executors, and Administrators
560 .. Retirement Plans for the Self-Employed
561 .. Determining the Value of Donated Property
564 .. Mutual Fund Distributions
570 .. Tax Guide for Individuals with Income from U.S. Possessions
571 .. Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations
575 .. Pension and Annuity Income (Including Simplified General Rule)
584 .. Nonbusiness Disaster, Casualty, and Theft Loss Workbook
587 .. Business Use of Your Home
590 .. Individual Retirement Arrangements (IRAs)
593 .. Tax Highlights for U.S. Citizens and Residents Going Abroad
594 .. Understanding The Collection Process
596 .. Earned Income Credit
597 .. Information on the United States-Canada Income Tax Treaty
721 .. Tax Guide to U.S. Civil Service Retirement Benefits
901 .. U.S. Tax Treaties
907 .. Tax Highlights for Persons with Disabilities
908 .. Tax Information on Bankruptcy
911 .. Tax Information for Direct Sellers
915 .. Social Security Benefits and Equivalent Railroad Retirement Benefits
917 .. Business Use of a Car
919 .. Is My Withholding Correct for 1995?
925 .. Passive Activity and At-Risk Rules
926 .. Employment Taxes for Household Employers
929 .. Tax Rules for Children and Dependents
936 .. Home Mortgage Interest Deduction
938 .. Real Estate Mortgage Investment Conduits (REMICs) Reporting Information
945 .. Tax Information for Those Affected by Operation Desert Storm
946 .. How To Begin Depreciating Your Property
947 .. Practice Before the IRS and Power of Attorney
950 .. Introduction to Estate and Gift Taxes
1244 .. Employee's Daily Record of Tips and Report to Employers
1542 .. Per Diem Rates
1544 .. Reporting Cash Payments of Over $10,000
1546 .. How to use the Problem Resolution Program of the IRS

Spanish Language Publications

1SP .. Derechos del Contribuyente
556SP .. Revisión de las Declaraciones de Impuesto, Derecho de Apelación y Reclamaciones de Reembolsos
579SP .. Cómo Preparar la Declaración de Impuesto Federal
594SP .. Comprendiendo el Proceso de Cobro
596SP .. Crédito por Ingreso del Trabajo
850 .. English–Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service

Tax forms, publications and instructions listed on the order blank

You can get the following forms, schedules, and instructions at participating banks, post offices, or libraries.

Form 1040
Instructions for Form 1040 & Schedules
Schedule A for itemized deductions
Schedule B for interest and dividend income if over $400; and for answering the foreign accounts or foreign trusts questions
Schedule EIC for the earned income credit
Form 1040A
Instructions for Form 1040A & Schedules
Schedule 1 for Form 1040A filers to report interest and dividend income
Schedule 2 for Form 1040A filers to report child and dependent care expenses
Form 1040EZ
Instructions for Form 1040EZ

You can photocopy the items listed below (as well as those listed above) at participating libraries or order them from the IRS.

Schedule 3, Credit for the Elderly or the Disabled for Form 1040A Filers
Schedule C, Profit or Loss From Business
Schedule C-EZ, Net Profit From Business
Schedule D, Capital Gains and Losses
Schedule E, Supplemental Income and Loss
Schedule F, Profit or Loss From Farming
Schedule R, Credit for the Elderly or the Disabled
Schedule SE, Self-Employment Tax
Form 1040-ES, Estimated Tax for Individuals
Form 1040X, Amended U.S. Individual Income Tax Return
Form 2106, Employee Business Expenses
Form 2106-EZ, Unreimbursed Employee Business Expenses
Form 2119, Sale of Your Home
Form 2210, Underpayment of Estimated Tax by Individuals and Fiduciaries
Form 2441, Child and Dependent Care Expenses
Form 3903, Moving Expenses
Form 4562, Depreciation and Amortization
Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
Form 5329, Return for Additional Taxes Attributable to Qualified Retirement Plans, Annuities, and Modified Endowment Contracts
Form 8283, Noncash Charitable Contributions
Form 8582, Passive Activity Loss Limitations
Form 8606, Nondeductible IRA Contributions, IRA Basis, and Nontaxable IRA Distributions
Form 8822, Change of Address
Form 8829, Expenses for Business Use of Your Home

How to Get IRS Forms and Publications

You can visit your local IRS office or order tax forms and publications from the IRS Forms Distribution Center listed for your state at the address on this page. Or, if you prefer, you can photocopy tax forms from reproducible copies kept at participating public libraries. In addition, many of these libraries have reference sets of IRS publications that you can read or copy.

Where To Mail Your Order Blank for Free Forms and Publications

If you live in:	Mail to:
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Kansas, Montana, Nevada, New Mexico, Oklahoma, Oregon, Utah, Washington, Wyoming, Guam, Northern Marianas, American Samoa	Western Area Distribution Center Rancho Cordova, CA 95743-0001
Alabama, Arkansas, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Texas, Wisconsin	Central Area Distribution Center P.O. Box 8903 Bloomington, IL 61702-8903
Connecticut, Delaware, District of Columbia, Florida, Georgia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, West Virginia	Eastern Area Distribution Center P.O. Box 85074 Richmond, VA 23261-5074

Other locations:

Foreign Addresses— Taxpayers with mailing addresses in foreign countries should mail this order blank to either: Eastern Area Distribution Center, P.O. Box 25866, Richmond, VA 23286-8107; or Western Area Distribution Center, Rancho Cordova, CA 95743-0001, whichever is closer. Mail letter requests for other forms and publications to: Eastern Area Distribution Center, P.O. Box 25866, Richmond, VA 23286-8107.

Puerto Rico—Eastern Area Distribution Center, P.O. Box 25866, Richmond, VA 23286-8107.

Virgin Islands—V.I. Bureau of Internal Revenue, Lockhart Gardens, No. 1-A Charlotte Amalie, St. Thomas, VI 00802

Detach at This Line

Order Blank

We will send you 2 copies of each form and 1 copy of each publication or set of instructions you circle. Please cut the order blank on the dotted line above and **be sure to print or type your name and address accurately on the bottom portion.**

Enclose this order blank in your own envelope and address your envelope to the IRS address shown above for your state.

To help reduce waste, please order only the forms, instructions, and publications you think you will need to prepare your return.

Use the blank spaces to order items not listed. If you need more space, attach a separate sheet of paper listing the additional forms and publications you may need.

You should either receive your order or notification of the status of your order within 7-15 work days after we receive your request.

1040	Schedule F (1040)	1040EZ	2441 & Instructions	8822 & Instructions	Pub. 505	Pub. 554	
Instructions for 1040 & Schedules	Schedule R (1040) & Instructions	Instructions for 1040EZ	3903 & Instructions	8829 & Instructions	Pub. 508	Pub. 575	
Schedules A&B (1040)	Schedule SE (1040)	1040-ES (1995) & Instructions	4562 & Instructions	Pub. 1	Pub. 521	Pub. 590	
Schedule C (1040)	1040A	1040X & Instructions	4868 & Instructions	Pub. 17	Pub. 523	Pub. 596	
Schedule C-EZ (1040)	Instructions for 1040A & Schedules	2106 & Instructions	5329 & Instructions	Pub. 334	Pub. 525	Pub. 910	
Schedule D (1040)	Schedule 1 (1040A)	2106-EZ & Instructions	8283 & Instructions	Pub. 463	Pub. 527	Pub. 917	
Schedule E (1040)	Schedule 2 (1040A)	2119 & Instructions	8582 & Instructions	Pub. 501	Pub. 529	Pub. 929	
Schedule EIC (1040A or 1040)	Schedule 3 (1040A) & Instructions	2210 & Instructions	8606 & Instructions	Pub. 502	Pub. 550	Pub. 936	

Name

Number and street

City or town | State | ZIP code