

PASSIVE ACTIVITY LOSSES

BY

TAX EDUCATORS

31869 HERMAN RD., COBURG, OR 97408-9483

TOLL FREE Voice or FAX: 866-755-2853

or

Voice: 541-915-4915

<http://www.tax-educators.com>

tax-ed@tax-educators.com

DISCLAIMER

The materials and forms in this manual are published by Tax Educators exclusively for the use of tax return preparers in completion of this course.

Tax Educators does not make express or implied warranties in regard to the use of the materials/forms.

Each tax preparer must depend on his or her own knowledge of the law and expertise in the use or the modification of these materials.

Preparers must be aware that the laws are constantly changing and that the information in this manual may be superceded at any time.

ACKNOWLEDGMENTS

**Kleinrock - CCH
IRS: Forms & Publications
IRS: Letter Rulings
J. K. Lasser**

Tax Educators

31869 Herman Rd., Coburg, OR 97408-9483

**TOLL FREE Voice or FAX 866-755-2853
or
Voice: 541-915-4915**

**<http://www.tax-educators.com>
tax-ed@tax-educators.com**

PASSIVE ACTIVITIES

INTERNAL REVENUE CODE OF 1986 - CODE SECTION 469

The Tax Reform Act of 1986 was intended to SIMPLIFY the Federal income tax system and make it more equitable!!

Aimed at preventing taxpayers from sheltering income through deduction - generating investments, particularly limited partnerships.

Imposes limitations on taxpayer's use of losses and credits from so called "passive activities".

Congress felt that the ability of taxpayers to use losses from one activity to offset taxable income from another activity was eroding not only Federal tax revenues, but also public confidence in tax systems.

(Did the public have confidence in the tax system before????)

Coping with the PAL rules has been FAR FROM SIMPLE!! Many forms, numerous worksheets, instructions for completing the forms and worksheets and supplemental instructions have been issued in connection with PAL and credit limitations.

The original temporary and proposed regulations totaling 266 pages were only the beginning of activity in this area.

IRS assured taxpayers (and their overburdened tax return preparers) that "many" taxpayers would be able to comply with the rules simply by following the forms and instructions. Sounds simple enough??

The MAJOR problem created by the passive activity rules was:
the definition of ACTIVITY??

Notice: 2009-55 http://www.irs.gov/irb/2009-31_IRB/ar06.html (A list of transactions of Interest.)

Notice: 2009-59 http://www.irs.gov/irb/2009-31_IRB/ar07.html (Listed Transactions.)

PASSIVE ACTIVITIES

PASSIVE ACTIVITY IN GENERAL

In a passive activity if you have a trade or business activity in which you do not materially participate during the tax year, or a rental activity.

IF LOSS OCCURS - “AT RISK” RULES MUST BE APPLIED FIRST, THEN PASSIVE ACTIVITY LOSS RULES.

DEDUCTING PASSIVE ACTIVITY LOSSES

In general, under PAL rules, you are allowed to deduct passive activity losses only from passive activity income. The excess is carried forward to the following year until used, or until disposition of entire interest in the activity in a fully taxable transaction.

PASSIVE ACTIVITY RULES APPLY TO:

- ▶ Individuals
- ▶ Estates
- ▶ Trusts (Other than grantor trusts)
- ▶ Personal Service corporations:
- ▶ Closely held corporation
- ▶ Owners of pass through entity interests on their distributive shares of income or loss from those interests.

Interest in a limited partnership is presumed to be a passive activity.

Three exceptions under which a limited partner could meet the material participation rules:

- ▶ Participation by individual for more than 500 hours per year in the partnership
- ▶ Individual was material participant in any of 5 of the last 10 years of the partnership
- ▶ Individual was material participant in personal service activity in any of the preceding years of the partnership.

Limited liability companies are typically treated as partnerships per above

Publicly traded partnerships (PTP)

Passive activity loss rules must be applied separately to items of each PTP

A loss from one PTP can be offset only by income from that same PTP

PTP losses are NOT reported on form 8582

Unused losses are carried forward indefinitely to future years until there is income from that PTP or taxpayer disposes of the entire interest

Passive activity loss rules generally do not apply to C -corporations

S corporations are not directly affected by PAL rules.

PASSIVE ACTIVITIES

PERSONAL SERVICE CORPORATION

- ▶ Corporation other than S corp
- ▶ Principal activity during "testing period" is personal services
 - testing period generally the previous tax year
 - if new corporation:
 - testing period begins on first day of tax year and ends on earlier of:
 - ▶ last day of tax year
 - ▶ or last day of calendar year in which tax year begins
- Services substantially performed by employee-owners.
 - More than 20% of total compensation during testing period performed by employee-owners
- Employee-owners own more than 10% of fair market value of outstanding stock on last day of testing period.

Personal services:

- ✓ Health (including veterinary services)
- ✓ Law
- ✓ Engineering
- ✓ Architecture
- ✓ Accounting
- ✓ Actuarial science
- ✓ Performing arts
- ✓ Consulting.

Employee owners if **both** apply:

- An employee or performs personal services for or on behalf of the corporation as an independent contractor during ANY day of the testing period
- Owns ANY stock at ANY time during the testing period.

PASSIVE ACTIVITIES

CLOSELY HELD CORPORATIONS - (For passive activity rules)

Closely held if **all** of the following apply.

- ▶ A corporation other than an S corporation
- ▶ NOT a personal service corporation
- 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)

Not applicable to grantor trusts, partnerships and S corporations directly
(DO apply to the owners of such entities)

A **closely held corporation** can offset net active income with its passive activity loss.

It can offset the tax attributable to its net active income with its passive activity credits.

It can **NOT** offset its **PORTFOLIO** income with its passive activity loss.

CHANGE IN STATUS

Change in status (if personal service corporation ceases to be subject to PAL rules) does not relieve taxpayer from application of the PAL rules with respect to losses and credits incurred during the period in which the taxpayer **was** subject to PAL rules.

TAX EXEMPT CORPORATIONS

PAL rules do not distinguish for tax exempt corporations. It may be possible that UNRELATED BUSINESS INCOME of tax exempt corporations could be subject to PAL regulations.

TAX YEAR OF PARTNERSHIP/S CORPORATION/ESTATE/TRUST

Taxable year of the entity is period during which level of participation must be determined. Taxable year of the form 1040 is disregarded for this purpose.

PASSIVE ACTIVITIES
IDENTIFYING "ACTIVITIES" HISTORICAL

FOR TAX YEARS ENDING BEFORE MAY 11, 1992:

Generally: Each undertaking owned is a separate activity

Ownership:

Either directly or indirectly through a partnership ,S Corporation, estate or trust - BUT NOT THROUGH A C CORPORATION.

Undertaking:

Includes all the business and rental operations you conduct at the same location (directly or indirectly as per above).

Same location:

Same physical structure or within close proximity of one another.

Not at same location but treated as conducted at same location:

Treated as same location with which they are most closely associated under facts and circumstances rules. (Employees sent from an office to various home locations to provide services are considered as conducting operations at the central office.)

Rental and non-rental operations combined:

If undertaking conducts both rental and nonrental operations:
generally separate activities. **BUT** are **NOT** separate activities IF EITHER of the following applies:

- ◆ Rental operations, if treated as a separate activity would not be a rental activity.
- OR ◆ One type of operation predominates over the other to such an extent that it produces more than 80% of the basic undertaking's gross income.

Trade of business activities:

Generally: Combine undertakings into one activity if undertakings are similar and controlled by same interests.

Similar:

If there are predominant operations in each undertaking that are in the same line of business OR are vertically integrated.

Integrated businesses:

Two or more trade or business activities treated as a single activity if operations constitute a single integrated business, and the activities are controlled by the same interests.

Dependent upon all facts and circumstances such as:

- ✓ Operations at same location.
- ✓ Other persons conduct similar operations at one location.
- ✓ Operations are treated as a unit in accounting records.
- ✓ Operations owned by same person.
- ✓ Operations involve products or services that are commonly provided together.
- ✓ Operations serve the same customers
- ✓ Operations are coordinated with or rely on each other.
- ✓ The operations depend on each other for economic success.
- ✓ The operations are conducted under the same trade name.

PASSIVE ACTIVITIES
IDENTIFYING "ACTIVITIES"

FOR YEARS BEGINNING AFTER MAY 10, 1992

Shorter "facts and circumstances" test under which taxpayer may use any **reasonable** method of grouping activities. (reg. 1.469-4)

Generally 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 passive activity rules.

APPROPRIATE ECONOMIC UNIT

To determine if more than one activity forms an appropriate economic unit, consider all relevant facts and circumstances in grouping the activities.

Following factors have greatest weight:

- Similarities and differences in TYPES of business
- Extent of common CONTROL
- Extent of common OWNERSHIP
- Geographic LOCATION
- INTERDEPENDENCIES between activities
i.e: extent that the activities:
 - purchase or sell goods among themselves
 - involve products or services that are generally provided together.
 - Have the same customers
 - Have the same employeesor
 - Use a single set of books and records to account for the activities.

CONSISTENCY:

Generally, when activities are grouped into appropriate economic units they may not be regrouped in a later tax year.
Exception if original grouping becomes inappropriate may regroup but must disclose this action to IRS.

PASSIVE ACTIVITIES

RENTAL ACTIVITY

In general, may not group a rental activity with a trade or business activity.

Exception:

May group together if the activities form an appropriate economic unit
AND

- if rental activity is insubstantial in relation to the trade or business activity

OR

- trade or business activity is insubstantial to the rental activity

OR

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

In general, activity of rental real property can not be combined with an activity of rental of personal property as a single activity.

Exception:

If personal property is provided IN CONNECTION with real property, they can be treated as a single activity.

In general, limited partners or limited entrepreneurs may not group following activities with any other activity:

- ◆ Holding, producing, or distributing motion picture films/video tapes
- ◆ Farming
- ◆ Leasing any section 1245 property
- ◆ Exploring for, or exploiting, oil and gas resources
- ◆ Exploring for, or exploiting, geothermal deposits

Limited partners or limited entrepreneurs in activity above, may group that activity with:

- ◆ Another activity that is in the same type of business if limited partner or limited entrepreneur in BOTH activities
- ◆ Another activity in which not a limited partner or limited entrepreneur if the activity is the same type of business and the grouping is appropriate considering the relevant facts and circumstances.

Limited entrepreneur - a person who

- ◆ Has an interest in a business organization other than a limited partner
- ◆ AND does not actively participate in the management of the business organization.

PASSIVE ACTIVITIES

ACTIVITIES THROUGH PARTNERSHIPS OR S CORPORATIONS:

Partnership or S corporation must group activities under same rules

Once grouped by the pass through entity, partner or shareholder can group those activities

- ✓ With each other
- ✓ With activities conducted directly by taxpayer
- ✓ With activities conducted through other entities

May NOT treat activities grouped together by the entity as separate activities.

PUBLICLY TRADED PARTNERSHIPS MAY NOT BE COMBINED BY TAXPAYER WITH OTHER OPERATIONS INCLUDING OTHER PTPs.

PASSIVE ACTIVITIES

TWO KINDS OF PASSIVE ACTIVITIES

- ✓ **Trade or Business activities in which NO material participation**
 - ✓ Involves conduct of trade or business
 - ✓ Is conducted in anticipation of starting a trade or business
 - ✓ Involves research or experimental expenditures otherwise deductible or capitalized.

Trade or business activity does NOT include rental activity or rental of property that is incidental to an activity of holding property for investment

- ✓ **Rental activities ALWAYS PASSIVE!!**

Pre 1994 - Even if material participation - STILL PASSIVE!!

Beginning in 1994

Not passive activity if you materially participated **as a real estate professional**. (See definition later in this course)

Rental Activity is: (Not the same as rental real estate activity)

Tangible property (real or personal) used by customers or held for use by customers

and

Income or expected income from activity represents amounts paid mainly for use of the property.

Immaterial whether use is under lease, service contract or some other arrangement.

Generally, equipment leasing is a passive activity

Unless **equipment rental** falls in one of the six exceptions on next page it is a passive activity and losses are not deductible (unless taxpayer has other passive income)

Includes long term equipment rentals

Computers

Trucks

Heavy equipment

Medical equipment

Airplanes

Automobiles

Boats

Neither material participation or active participation rules apply

PASSIVE ACTIVITIES

NOT a rental activity if ANY of following apply:

- ✓ Average period of customer use 7 days or less.
- ✓ Average period of customer use is 30 days or less AND significant personal services are provided with the rentals.
- ✓ Extraordinary personal services are provided in connection with customer use.
- ✓ Rental is incidental to a nonrental activity.
- ✓ Customarily make rental property available during defined business hours for nonexclusive use by various customers
- ✓ Provide the property for use in a nonrental activity of your partnership, S corporation, or joint venture

If exceptions above are met and the activity is a trade or business in which material participation occurs, income is reported on normal forms and schedules.

PASSIVE ACTIVITIES

REAL ESTATE PROFESSIONAL

Real estate professional - Revenue Reconciliation Act of 1993 added Code section 469(c)(7) pertaining to rental **real estate** activities of real estate professionals. Individuals who qualify can treat their rental activities as nonpassive and any losses and credits can be used to offset taxpayer's nonpassive income. Passive loss restrictions are not applicable.

To qualify, taxpayer must satisfy **both** of two tests:

- ✓ More than 50% of personal services performed in the business are performed in real estate businesses in which taxpayer materially participates AND material participation in the real property trade or business exceeds 750 hours.
- ✓ Must show that taxpayer materially participated in the rental activity.

Joint return eligibility requirements

Do NOT count spouse's personal service to determine whether qualified real estate professional

But material participation requirement takes into account **BOTH** spouses participation

For this purpose each interest in rental real estate activity is a separate activity.

Can elect to aggregate all of rental activities of taxpayer as one activity in order to meet the material participation test. Election is made by attaching a statement to the original return containing a declaration that taxpayer qualifies as a real estate professional and is treating all rental activities as one activity

Real property trade or business:

Any real property trade or business involving:

- ▶ Development
- ▶ Redevelopment
- ▶ Construction
- ▶ Reconstruction
- ▶ Acquisition
- ▶ Conversion
- ▶ Rental
- ▶ Operation
- ▶ Management
- ▶ Leasing
- ▶ Brokerage

PASSIVE ACTIVITIES

REAL ESTATE PROFESSIONAL

A qualifying real estate professional who is a limited partner in his real estate rentals can qualify them to be nonpassive. Normally requires that taxpayer establish material participation.

Interests in rental real estate generally can NOT be combined with other trades or businesses.

Prior year suspended real estate rental losses do NOT qualify for total deduction in a year that an individual becomes a qualified real estate professional but will qualify for the \$25,000 offset if all normal qualifications are met.

Real estate professional rules are NOT ELECTIVE

If the tests are met - the net rental income will be non-passive and can not be used to offset other passive losses.

Report on form 1040 schedule E - indicates that qualified as real estate professional

Personal Services as an employee:

NOT treated as performed in trade or business unless that person has more than 10% ownership interest in the employer

Closely held "C" corporation

Can qualify if more than 50% of gross receipts came from real property trades or business in which it materially participates

PASSIVE ACTIVITIES

REAL ESTATE RENTAL ACTIVITIES

Individuals with ACTIVE participation in rental **real estate** can deduct up to \$25,000 of losses from **non passive** income each year.

AND

Credits from sch activities can be applied against total tax on up to \$25,000 of NON passive income after losses.

Exception: Married filing separate and **lived apart** from spouse for **entire tax year**, offset amount cannot exceed \$12,500.

Married and **LIVED with spouse at any time** and file separate, **no special offset allowed**.

PHASE OUT

\$25,000 phases out at rate of 50 cents for each dollar by which AGI (modified) exceeds \$100,000.

Complete phase out at \$150,000 **modified AGI**. (Defined later)

Married filing separate and lived apart for entire year -
Reduce 50 cents for each dollar by which modified AGI exceeds \$50,000 with complete phase out at \$75,000

FLOW THROUGH (from partnerships/S corporations) losses can qualify for the \$25,000 offset as long as the **taxpayer** meets the active participation standards

PASSIVE ACTIVITIES

ACTIVE PARTICIPATION:

Not the same as MATERIAL participation

Treated as ACTIVE participation if:

- ▶ make management decisions that are relevant
 - approving new tenants
 - deciding rental terms
 - approving expenditures

Only INDIVIDUALS can actively participate in rental real estate activity.

Losses can not be from a trust (except Grantor Trust)

Losses can not be from an entity under a net lease

Vacation homes that have an average period of customer use which is 7 days or less do not meet the definition of a “rental” - \$25,000 offset does not apply

Decedent's estate treated as active participant for tax years ending less than 2 years after death, IF decedent would have satisfied active requirements.

Limited partners and those who own less than 10% of the activity do NOT meet the active participation requirements

Taxpayer and spouse's combined interest must be a least 10% of all interests in the activity throughout the year.

Active participation not required to take low income housing and rehabilitation investment credits from rental real estate activities.

PASSIVE ACTIVITIES

MODIFIED ADJUSTED GROSS INCOME: (For computation of phaseout)

Computed **WITHOUT:**

- ◆ Taxable social security and railroad retirement payments
- ◆ Deductible contributions to IRA and retirement plans in sec. 501(c)(18)
- ◆ Exclusion of income from US savings bonds used to pay higher education fees
- ◆ Any passive activity loss
- ◆ An overall loss from publicly traded partnership
- ◆ Deduction for half of self employment tax.
- ◆ Exclusion from income of amounts received from employer's adoption Assistance program
- ◆ Deduction allowed for interest on student loans.

PASSIVE ACTIVITIES

HIGHER PHASE OUT RULE FOR CERTAIN CREDITS.

Phase out for low income housing credits for property placed in service before 1990

and

Phase out for rehabilitation investment credits from rental real estate activities

For the above two credits:

Phase out of \$25,000 offset begins when modified AGI exceeds \$200,000
(\$100,000 MFS and lived apart at all times during year)

No phase out of \$25,000 offset for low income housing property
placed in service after 1989

If indirect interest in the property through a pass through entity,
this special exception does not apply unless acquired INTEREST
in the pass through entity after 1989.

APPLICATION OF \$25,000 OFFSET

First to passive activity losses

Second to credits other than rehabilitation and low income housing

Third to credits for rehabilitation and low income housing investment credits
from property acquired prior to 1990

Finally to low income housing credits for property acquired after 1989

**QUALIFIED RENTAL REAL ESTATE LOSSES THAT ARE SUSPENDED MAY BE
DEDUCTIBLE IN A SUBSEQUENT YEAR IF ANY OF THE \$25,000 OFFSET IS
AVAILABLE.**

PASSIVE ACTIVITIES

NOT PASSIVE ACTIVITIES

- Trade or business with material participation
- Working interest in oil or gas well held directly or through an entity that does not limit liability (general partner) - does not matter if material participation or not.
- Rental of dwelling unit used as a residence (temporary rental rules)
- Activity of trading personal property for those who own interest in the activity.
- Rental real estate activities in which material participated as a real estate professional.

- **Income from self rented property**
If taxpayer rents real property or equipment to a trade or business in which he or she materially participates, net rental income from the property is treated as nonpassive income. (Not applicable if written binding contract entered into before February 19, 1988)
Effective with 1993 tax year for C corporations.

DO NOT INCLUDE INCOME OR LOSSES FROM THE ABOVE WITH PASSIVE ACTIVITIES

PASSIVE ACTIVITIES

MATERIAL PARTICIPATION

MUST SATISFY “ONE” OF THE FOLLOWING TESTS

- ✓ Participated in activity for more than 500 hours
- ✓ Participation is substantially all of the participation in the activity of all of the individuals, including participation of individuals who did not own any interest in the activity.
- ✓ Participated in activity more than 100 hours during tax year AND participated at least as much as any other individual (including non owners)
- ✓ Activity is a significant participation activity and you participated in all significant participation activities for more than 500 hours.
Significant participation activity: any trade or business activity in which you participated 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.
- ✓ Materially participated in activity for any 5 (whether or not consecutive) of the 10 preceding tax years. In determining whether material participation for years before 1987 - only if more than 500 hours during that year.
- ✓ Activity is a personal service activity in which you participated for any 3 (whether or not consecutive) preceding tax years. (Before 1987 only if more than 500 hours)
- ✓ Based on all the facts and circumstances, you participated in the activity on a regular, continuous and substantial basis.
(Not less than 100 hours)

Management participation does not count for material participation IF:

- any person other than you received compensation for management
- Any individual spent more hours during the tax year managing the activity than you did (regardless of compensation)

FOR “MATERIAL PARTICIPATION” - SPOUSE'S (BUT NOT CHILDREN) PARTICIPATION INCLUDED WITH TAXPAYER'S PARTICIPATION IF MARRIED EVEN IF SPOUSE AND NO OWNERSHIP AND EVEN IF NOT FILING JOINT RETURN.

PASSIVE ACTIVITIES

PARTICIPATION

In general - Any work done in connection with activity in which you own an interest.

Work not usually performed by owners:

Not treated as participation in the activity IF:

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

Work done in capacity as an **investor** in an activity is not treated as participation unless directly involved in day to day management or operations of the activity

Examples of NON participation as an investor:

- Studying and reviewing financial statements/reports
- Preparing or compiling summaries or analyses of finances or operations of the activity for own use
- Monitoring the finances or operations of the activity in a Non-managerial capacity.

PROOF OF PARTICIPATION:

Any reasonable method

Does not have to be contemporaneous daily time reports

Can use appointment book, calendar, or narrative summary

LIMITED PARTNERS

Generally did not materially participate

Exception: can qualify if meet test 1,5, or 6

Not treated as a limited partner if were general partner ALL year

PASSIVE ACTIVITIES

PARTICIPATION

RETIRED OR DISABLED FARMER AND SURVIVING SPOUSE OF FARMER

Treated as materially participating in farming activity if materially participated 5 of the 8 years before retirement or disability.

Surviving spouse of farmer - treated as materially participating in farming if the real property used in the activity meets the estate tax rules for special valuation of farm property AND you ACTIVELY manage the farm.

CORPORATIONS

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.

PASSIVE ACTIVITIES

PASSIVE ACTIVITY INCOME

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

NONPASSIVE INCOME

Income from passive activities does NOT include income such as:

- Income from nonpassive activity
- Gain from disposition of substantially appreciated property that had been used in a NON passive activity.
Gain is PASSIVE if property used in a passive activity:
 - 20% of time held
 - or
 - entire 24 month period ending on disposition date.
- Portfolio income

**Self charged interest (lending money to taxpayer's own partnership or S corporation that conducts a passive activity)
The interest income is recharacterized from portfolio to passive income. Applies only to INTEREST income and expense, not to any other self charged items.**

- Personal service income
 - Wages, salaries, commissions
 - Self employment income from trade or business
 - Deferred compensation
 - Taxable social security benefits
 - Payments to partners for personal services
- Income from positive sect. 481 adjustments (due to changes in accounting method)
- Income or gain from investments of working capital
- Income from an oil or gas property if treated any loss from a working interest as nonpassive loss.
- Income from intangible property if personal efforts significant to creation of
- Income from any interest in a publicly traded partnership

Continued on next page

PASSIVE ACTIVITIES

NON passive income (continued)

- Income from qualified low income housing project for any year in the relief period in which losses would not be subject to passive loss limits under special transitional rules
- Any other income that must be treated as nonpassive
- State, local and foreign income tax refunds
- Income from covenant not to compete
- Income attributable to reimbursement of a loss from a casualty or theft if loss is not passive deduction
- Alaska Permanent Fund dividends
- Cancellation of debt income if at the time debt is discharged, the income is not allocated to passive activity expenditures.
- Sale of undeveloped land or other investment property
- Royalties derived in ordinary course of business
- Businesses, Partnerships, S corporations, and Limited liability Companies in which taxpayer materially participates.
- Trusts in which fiduciary materially participates

NEW 2006 TRANSACTIONS WITH A SIGNIFICANT BOOK-TAX DIFFERENCE

No longer required to be reported on returns filed with due dates of January 5, 2006 and after.

No longer need Form 8886.

PASSIVE ACTIVITIES

PASSIVE ACTIVITY DEDUCTIONS

Passive activity deductions include:

- All deductions from activities that are passive activities for the tax year
- All deductions from passive activities that were disallowed under passive activity loss rules in prior years and carried forward to current year.
- Losses from dispositions of property used in a passive activity at the time of disposition of less than entire interest in passive activity.

Passive activity deductions do **NOT** include:

- Expenses (other than interest) that are clearly and directly allocable to portfolio income.
- Interest expense other than interest properly allocable to passive activities
- Losses from dispositions of property that produces portfolio income or property held for investment
- State, local, and foreign income taxes
- Misc. Itemized deductions that may be disallowed because of 2% AGI limit
- Charitable contributions
- Net operating loss deductions
- Percentage depletion carryovers for oil and gas wells
- Capital loss carrybacks and carryovers
- Deductions and losses that would have been allowed for tax years beginning before 1987 but for basis or at risk limits.
- Net negative section 481 adjustments (change in accounting methods)
- Casualty and theft losses, unless losses similar in cause and severity recur regularly in the activity
- Deduction for one half of self employment tax.

PASSIVE ACTIVITIES

RECHARACTERIZATION OF PASSIVE INCOME

And now that you know how to define passive activities, you may have to recharacterize and exclude income from passive activity income.

Recharacterization issues apply only to INCOME, not losses

Combine income and losses from the ACTIVITY during the year.

If net loss, treat the income and losses the same as any other income or losses from that type of passive activity

If result is net income, do not include income or losses from the activity in passive activity computations. Enter on NORMAL schedules/forms

Equity financed lending activities

Lesser of net passive income or equity financed interest income is NON passive income.

Rental of property incidental to a development activity

Treated as Non passive if ALL of following apply:

- recognize gain from sale, exchange, other disposition of rental property during tax year
- Started to rent the item less than 12 months before date of disposition
- materially participated or significantly participated for any tax year that involved the performance of services for the purpose of enhancing the value of the property.

Property rented to an activity in which taxpayer materially participates

Licensing of intangible property by pass through entity

Rental of non-depreciable property

If 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 IR code, the net passive income is treated as non passive income.

(Example - mobile home parks and activities involving ground rents)

If LOSS, treated same as any other passive activity loss - may qualify for active participation rules.

PASSIVE ACTIVITIES

RECHARACTERIZATION OF PASSIVE INCOME (Continued)

Significant participation passive activities

If passive activity gross income from significant participation passive activities exceeds your passive activity deductions from those activities, a ratable portion of net income from EACH significant participation passive activity is treated as non passive.

Significant participation passive activity definition:

trade or business activity in which participate for more than 100 hours during the year but did NOT MATERIALLY participate.

Worksheet Significant Participation Passive Activities				
Name of Activity	(a) Hours of Participation	(b) Net loss	(c) Net income	(d) Combine Totals of cols (b) and (c)
Totals				

WORKSHEET - SIGNIFICANT PARTICIPATION ACTIVITIES				
Name of Activity with net income	(a) Net Income	(b) Ratio	(c) Nonpassive income	(d) Passive income Subtract (c) from (a)
Totals		100%		

**DISPOSITIONS
OF
PASSIVE ACTIVITIES**

PASSIVE ACTIVITIES

DISPOSITIONS

Any unallowed losses (but not credits) that have not been allowed (including current year losses) generally are allowed in full in the year of disposition of entire interest in the activity and in a transaction in which all realized gain or loss is recognized and to a unrelated party.

Capital losses on disposition may be limited by capital loss limits.

If all gain or loss realized on disposition is RECOGNIZED, the excess of:

- The sum of:
 - any loss from the activity for the tax year (including losses carried over from prior years) plus
 - any loss realized on the disposition

over

- 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.

NOT CONSIDERED FULLY TAXABLE TRANSACTIONS AND DO NOT TRIGGER RELEASE OF CURRENT AND SUSPENDED LOSSES:

- ✓ Exchange in which there is no recognition of gain
- ✓ Sale to a related party
- ✓ Disposition by Gift (see below)
- ✓ Transfer incident to divorce treated as a gifts
- ✓ Death of owner creates deduction on final return if current and suspended Losses of the activity exceed the step up in basis.
- ✓ Conversion to personal use
- ✓ Transfer to a corporation, partnership or LLC

INSTALLMENT SALES OF ENTIRE INTEREST:

Losses allowed each year in same ratio of gain recognized in the tax year to the gain remaining to be recognized at beginning of year.

PARTNERSHIP INTEREST/S CORPORATION STOCK

Not considered property used in activity.

Entity may own a variety of assets and may be engaged in several activities

Determination of whether gain is passive is made at the ACTIVITY level not at the ENTITY level. Regulations require that partner/shareholder gain be allocated among the various activities of the entity.

DISPOSITION BY GIFT

Accumulated unused PAL's can not be deducted in any year!!

Basis of transferred interest must be increased by amount of any such unallowed losses.

COMPLETE ABANDONMENT OF A PASSIVE ACTIVITY

Is a taxable disposition which triggers deductibility of suspended losses

PASSIVE ACTIVITIES

DISPOSITIONS

IF TAXPAYER BECOMES A MATERIAL PARTICIPANT OR CONVERTS RENTAL PROPERTY TO PERSONAL RESIDENCE

Suspended losses remain suspended until the activity is converted back to a passive activity or the activity is disposed of in a qualifying disposition.

PARTIAL DISPOSITIONS

If dispose of a substantial part of an activity, may treat that part of an activity as a separate activity. Must show with reasonable certainty

- ◆ The amount of prior year deductions and credits disallowed under PAL rules is allocable to the substantial part of the activity

and

- ◆ The amount of income and other deductions or credits that is allocable to the substantial part of the activity for the current year.

NET INCOME FROM DISPOSITION OF SUBSTANTIALLY APPRECIATED PROPERTY

Treated as NOT from a passive activity UNLESS

- Used in a passive activity for EITHER
 - ▶ 20% of taxpayer's holding period
 - ▶ Entire 2 year period ending on date of disposition

Substantial appreciation occurs if FMV exceeds 120% of the adjusted basis.

ASSET USED IN MORE THAN ONE ACTIVITY DURING 12 MONTHS BEFORE DISPOSITION

Gain or loss realized must be allocated between the activities on a basis that is reasonable to reflect the use of such property.

**REMEMBER THAT "AT RISK" RULES MUST
BE APPLIED BEFORE PASSIVE ACTIVITY
RULES ARE APPLIED!!**

MISCELLANEOUS 'TIDBITS'

Temporary rental of taxpayer's personal residence is not a passive activity. Vacation home rules apply to determine if "temporary".

Investment interest from a passive activity after 1990 generally should be reported on form 8582 and is NOT deductible until taxpayer has income from passive activities.

Deemed to be passive interest. Interest that is properly allocable to portfolio income from a pass through entity IS investment interest expense and may be deducted on form 4952

Net operating losses - When regular NOL and a suspended loss from passive activity are carried forward into same year, passive activity loss carryforward is first applied against passive income before the regular NOL

Alternative Minimum Tax - Two form 8582s are required to compute AMT for passive activities and regular AMT

Casualty losses -suffered by a passive activity are not treated as a passive deduction and are allowed in full in the year sustained. Insurance reimbursements for casualty losses are not treated as passive and are not passive income.

PASSIVE ACTIVITIES CREDITS

Form 8582-CR is used by noncorporate taxpayers to figure the amount of any passive activity credit for the current year (including any prior year unallowed credits) and the amount of credit allowed for the current year.

It is also used to make the election to increase the basis of credit property when a taxpayer disposes of his or her interest in an activity.

Passive activity credits that are not allowed in the current year are carried forward until they are allowed against the tax on either net passive income or the special allowance, if applicable.

Applies to credits from passive activities from:

- ▶ Investment credits including
 - rehabilitation credit
 - energy credit
 - reforestation credit

- ◆ Work opportunity credit

- ◆ Credit for alcohol used as fuel

- ◆ Credit for increasing research activities

- ◆ Low income housing credit

- ◆ Enhanced oil recovery credit

- ◆ Disabled access credit

- ◆ Renewable electricity production credit

- ◆ Empowerment zone employment credit

- ◆ Indian employment credit

- ◆ Credit for employer social security and medicare taxes paid on certain employee tips

- ◆ Orphan drug credit

- ◆ Credit for contributions to selected community development corporations

- ◆ Non-conventional source fuel credit

- ◆ Qualified electric vehicle credit.

Forms follow: 8582 & 8582-CR

Passive Activity Credit Limitations

▶ See separate instructions.

▶ Attach to Form 1040 or 1041.

Name(s) shown on return

Identifying number

Part I Passive Activity Credits

Caution: If you have credits from a publicly traded partnership, see **Publicly Traded Partnerships (PTPs)** on page 14 of the instructions.

Credits From Rental Real Estate Activities With Active Participation (Other Than Rehabilitation Credits and Low-Income Housing Credits) (See Lines 1a through 1c on page 9.)

1a	Credits from Worksheet 1, column (a)	1a			
b	Prior year unallowed credits from Worksheet 1, column (b)	1b			
c	Add lines 1a and 1b	1c			

Rehabilitation Credits From Rental Real Estate Activities and Low-Income Housing Credits for Property Placed in Service Before 1990 (or From Pass-Through Interests Acquired Before 1990) (See Lines 2a through 2c on page 9.)

2a	Credits from Worksheet 2, column (a)	2a			
b	Prior year unallowed credits from Worksheet 2, column (b)	2b			
c	Add lines 2a and 2b	2c			

Low-Income Housing Credits for Property Placed in Service After 1989 (See Lines 3a through 3c on page 9.)

3a	Credits from Worksheet 3, column (a)	3a			
b	Prior year unallowed credits from Worksheet 3, column (b)	3b			
c	Add lines 3a and 3b	3c			

All Other Passive Activity Credits (See Lines 4a through 4c on page 10.)

4a	Credits from Worksheet 4, column (a)	4a			
b	Prior year unallowed credits from Worksheet 4, column (b)	4b			
c	Add lines 4a and 4b	4c			

5	Add lines 1c, 2c, 3c, and 4c	5			
6	Enter the tax attributable to net passive income (see page 10)	6			
7	Subtract line 6 from line 5. If line 6 is more than or equal to line 5, enter -0- and see page 10	7			

Note: If your filing status is married filing separately and you lived with your spouse at any time during the year, **do not** complete Part II, III, or IV. Instead, go to line 37.

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

Note: Complete this part only if you have an amount on line 1c. Otherwise, go to Part III.

8	Enter the smaller of line 1c or line 7	8			
9	Enter \$150,000. If married filing separately, see page 10	9			
10	Enter modified adjusted gross income, but not less than zero (see page 10). If line 10 is equal to or more than line 9, skip lines 11 through 15 and enter -0- on line 16	10			
11	Subtract line 10 from line 9	11			
12	Multiply line 11 by 50% (.50). Do not enter more than \$25,000. If married filing separately, see page 10.	12			
13a	Enter the amount, if any, from line 10 of Form 8582	13a			
b	Enter the amount, if any, from line 14 of Form 8582	13b			
c	Add lines 13a and 13b.	13c			
14	Subtract line 13c from line 12	14			
15	Enter the tax attributable to the amount on line 14 (see page 10)	15			
16	Enter the smaller of line 8 or line 15	16			

Part III Special Allowance for Rehabilitation Credits From Rental Real Estate Activities and Low-Income Housing Credits for Property Placed in Service Before 1990 (or From Pass-Through Interests Acquired Before 1990)

Note: Complete this part only if you have an amount on line 2c. Otherwise, go to Part IV.

17	Enter the amount from line 7				17		
18	Enter the amount from line 16				18		
19	Subtract line 18 from line 17. If zero, enter -0- here and on lines 30 and 36, and then go to Part V				19		
20	Enter the smaller of line 2c or line 19				20		
21	Enter \$250,000. If married filing separately, see page 13. (See page 13 to find out if you can skip lines 21 through 26.)			21			
22	Enter modified adjusted gross income, but not less than zero. (See instructions for line 10 on page 10.) If line 22 is equal to or more than line 21, skip lines 23 through 29 and enter -0- on line 30			22			
23	Subtract line 22 from line 21			23			
24	Multiply line 23 by 50% (.50). Do not enter more than \$25,000. If married filing separately, see page 13.			24			
25a	Enter the amount, if any, from line 10 of Form 8582	25a					
b	Enter the amount, if any, from line 14 of Form 8582	25b					
c	Add lines 25a and 25b.			25c			
26	Subtract line 25c from line 24			26			
27	Enter the tax attributable to the amount on line 26 (see page 13)			27			
28	Enter the amount, if any, from line 18			28			
29	Subtract line 28 from line 27				29		
30	Enter the smaller of line 20 or line 29				30		

Part IV Special Allowance for Low-Income Housing Credits for Property Placed in Service After 1989

Note: Complete this part only if you have an amount on line 3c. Otherwise, go to Part V.

31	If you completed Part III, enter the amount from line 19. Otherwise, subtract line 16 from line 7				31		
32	Enter the amount from line 30				32		
33	Subtract line 32 from line 31. If zero, enter -0- here and on line 36				33		
34	Enter the smaller of line 3c or line 33				34		
35	Tax attributable to the remaining special allowance (see page 13)				35		
36	Enter the smaller of line 34 or line 35				36		

Part V Passive Activity Credit Allowed

37	Passive Activity Credit Allowed. Add lines 6, 16, 30, and 36. See page 13 to find out how to report the allowed credit on your tax return and how to allocate allowed and unallowed credits if you have more than one credit or credits from more than one activity. If you have any credits from a publicly traded partnership, see Publicly Traded Partnerships (PTPs) on page 14				37		
-----------	---	--	--	--	-----------	--	--

Part VI Election To Increase Basis of Credit Property

38	If you disposed of your entire interest in a passive activity or former passive activity in a fully taxable transaction, and you elect to increase your basis in credit property used in that activity by the unallowed credit that reduced your basis in the property, check this box. See page 15 <input type="checkbox"/>						
39	Name of passive activity disposed of <input type="checkbox"/>					
40	Description of the credit property for which the election is being made <input type="checkbox"/>					
41	Amount of unallowed credit that reduced your basis in the property <input type="checkbox"/>						\$

Instructions for Form 8582-CR

(Rev. December 2010)



Department of the Treasury
Internal Revenue Service

For use with Form 8582-CR (Rev. December 2009)

Passive Activity Credit Limitations

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

What's New

Disclosure requirements for groupings. For tax years beginning after January 24, 2010, disclosure requirements for groupings of trade or business activities or rental activities apply. See Disclosure Requirement on page 5.

Purpose of Form

Form 8582-CR is used by noncorporate taxpayers to figure the amount of any passive activity credit (PAC) for the current tax year (including any prior year unallowed credits) and the amount of credit allowed for the current year. It also is used to make the election to increase the basis of credit property when a taxpayer disposes of his or her interest in an activity.

PACs that are not allowed in the current year are carried forward until they are allowed against the tax on either net passive income or the special allowance, if applicable.

Different rules apply to your activities and the related credit, depending on the type of activity. Generally, passive activities include:

- Trade or business activities in which you did not materially participate for the tax year.
- Rental activities, regardless of your participation.

See *Trade or Business Activities* on page 3 and *Rental Activities* beginning on this page.

For more information, see Pub. 925, *Passive Activity and At-Risk Rules*.

Note. Corporations subject to the passive activity rules must use Form 8810, *Corporate Passive Activity Loss and Credit Limitations*.

Who Must File

Form 8582-CR is filed by individuals, estates, and trusts with any of the following credits from passive activities.

- General business credits.

- Qualified plug-in electric and electric vehicle credit.

Overview of Form

The form contains six parts. The *Specific Instructions*, starting on page 8, include, at the beginning of the instructions for each part, a brief explanation of the purpose or use of that part. These explanations give a general overview of how the form works.

Also, as you read the instructions that follow, see *Example of How To Complete Form 8582-CR*, beginning on page 5. The example goes through a six-step analysis of how the form and worksheets are completed for a partner in a limited partnership that has a low-income housing credit.

Activities That Are Not Passive Activities

The following are not passive activities.

1. Trade or business activities in which you materially participated for the tax year.
2. Any rental real estate activity in which you materially participated if you were a "real estate professional" for the tax year. You were a real estate professional only if:
 - a. More than half of the personal services you performed in trades or businesses during the tax year were performed in real property trades or businesses in which you materially participated, and
 - b. You performed more than 750 hours of services during the tax year in real property trades or businesses in which you materially participated.

For purposes of item (2), each interest in rental real estate is a separate activity unless you elect to treat all interests in rental real estate as one activity.

If you are married filing jointly, one spouse must separately meet both (2)(a) and (2)(b) without taking into account services performed by the other spouse.

A real property trade or business is any real property development, redevelopment, construction, reconstruction, acquisition,

conversion, rental, operation, management, leasing, or brokerage trade or business.

Services you performed as an employee are not treated as performed in a real property trade or business unless you owned more than 5% of the stock (or more than 5% of the capital or profits interest) in the employer.

3. 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). In this case, it does not matter whether you materially participated in the activity for the tax year.

If, however, 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).

4. 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 unit that you also used as a home during the year for a number of days that exceeds the greater of 14 days or 10% of the number of days during the year that the home was rented at a fair rental.

5. An activity of trading personal property for the account of owners of interests in the activity. For purposes of this rule, personal property means property that is actively traded, such as stocks, bonds, and other securities. See Temporary Regulations section 1.469-1T(e)(6).

Generally, credits from these activities are not entered on Form 8582-CR. However, credits from these activities may be subject to limitations other than the passive credit limitation rules.

Rental Activities

A rental activity is a passive activity even if you materially participated in

the activity (unless it is a rental real estate activity in which you materially participated and you were a real estate professional).

However, if you meet any of the five exceptions listed below, the rental of the property is not treated as a rental activity. See *Reporting Credits From the Activities* on this page if you meet any of the exceptions.

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

An activity is not a rental activity if any of the following exceptions are met.

1. The average period of customer use is:
 - a. 7 days or less, or
 - b. 30 days or less and significant personal services were provided in making the rental property available for customer use.

Figure the average period of customer use for a class of property by dividing the total number of days in all rental periods by the number of rentals during the tax year. If the activity involves renting more than one class of property, multiply the average period of customer use of each class by the ratio of the gross rental income from that class to the activity's total gross rental income. The activity's average period of customer use equals the sum of these class-by-class average periods weighted by gross income. See Regulations section 1.469-1(e)(3)(iii).

Significant personal services include only services performed by individuals. To determine if personal services are significant, all relevant facts and circumstances are considered. Facts and circumstances include the frequency of the services, the type and amount of labor required to perform the services, and the value of the services relative to the amount charged for use of the property.

2. Extraordinary personal services were provided in making the rental property available for customer use. This applies only if the services are performed by individuals and the customers' use of the rental property is incidental to their receipt of the services.

3. Rental of the property 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 is less than 2% of the smaller of the unadjusted basis or the fair market value (FMV) of the property.

Unadjusted basis is the cost of the property without regard to depreciation deductions or any other basis adjustment described in section 1016.

The rental of property is incidental to a trade or business activity if:

- a. You own an interest in the trade or business activity during the tax year,
 - b. The rental property was mainly used in the trade or business activity during the tax year or during at least 2 of the 5 preceding tax years, and
 - c. The gross rental income from the property is less than 2% of the smaller of the unadjusted basis or the FMV of the property.
- Lodging provided for the employer's convenience to an employee or the employee's spouse or dependents is incidental to the activity or activities in which the employee performs services.
4. You customarily make the rental property available during defined business hours for nonexclusive use by various customers.
 5. You provide property for use in a nonrental activity of a partnership, S corporation, or joint venture in your capacity as an owner of an interest in the partnership, S corporation, or joint venture.

Reporting Credits From the Activities

If an activity meets any of the five exceptions listed above, it is not a rental activity. You must then determine:

1. Whether your rental of the property is a trade or business activity (see *Trade or Business Activities* on page 3) and, if so,
2. Whether you materially participated in the activity for the tax year (see *Material Participation* beginning on page 3).

- If the activity is a trade or business activity in which you did not materially participate, enter the credits from the activity on Worksheet 4 on page 9.
- If the activity is a trade or business activity in which you did materially participate, report the credits from the activity on the forms you normally use.

If the rental activity did not meet any of the five exceptions, it is generally a passive activity. Special rules apply if you conduct the rental activity through a publicly traded partnership (PTP). See *Publicly*

Traded Partnerships (PTPs) on page 14.

If the rental activity is not conducted through a PTP, the passive rental activity is entered in Worksheet 1, 2, 3, or 4 on pages 8 and 9.

Worksheet 1 is for credits (other than rehabilitation credits and low-income housing credits) from passive rental real estate activities in which you actively participated. See *Special Allowance for Rental Real Estate Activities* beginning on this page.

Worksheet 2 is for rehabilitation credits from passive rental real estate activities and low-income housing credits for property placed in service before 1990. This worksheet is also used for low-income housing credits from a partnership, S corporation, or other pass-through entity if your interest in the pass-through entity was acquired before 1990, regardless of the date the property was placed in service.

Worksheet 3 is for low-income housing credits for property placed in service after 1989 (unless held through a pass-through entity in which you acquired your interest before 1990).

Worksheet 4 is for credits from passive trade or business activities in which you did not materially participate and passive rental real estate activities in which you did not actively participate (but not rehabilitation credits from passive rental real estate activities or low-income housing credits).

Special Allowance for Rental Real Estate Activities

If you actively participated in a passive rental real estate activity, you may be able to claim credits from the activity for the tax attributable to a special allowance of up to \$25,000, reduced by any passive losses, including the commercial revitalization deduction, allowed under this exception on Form 8582, Passive Activity Loss Limitations.

The special allowance also applies to low-income housing credits and rehabilitation credits from a rental real estate activity, even if you did not actively participate in the activity. The credits allowed under the special allowance are in addition to the credits allowed for the tax attributable to net passive income.

The special allowance is not available if you were married at the end of the year, are filing a separate return for the year, and lived with your spouse at any time during the year.

Only an individual, a qualifying estate, or a qualified revocable trust that made an election to treat the

trust as part of the decedent's estate may actively participate in a rental real estate activity. Unless future regulations provide an exception, limited partners are not treated as actively participating in a partnership's rental real estate activity.

A qualifying estate is the estate of a decedent for tax years ending less than 2 years after the date of the decedent's death if the decedent would have satisfied the active participation requirements for the rental real estate activity for the tax year the decedent died.

A qualified revocable trust may elect to be treated as part of a decedent's estate for purposes of the special allowance for active participation in rental real estate activities. The election must be made by both the executor (if any) of the decedent's estate and the trustee of the revocable trust. For details, see Regulations section 1.645-1.

You are not considered to actively participate in a rental real estate activity if at any time during the tax year your interest (including your spouse's interest) in the activity was less than 10% (by value) of all interests in the activity.

Active participation is a less stringent requirement than material participation (see *Material Participation* beginning on this page). You may be treated as actively participating if, for example, you participated in making management decisions or arranging for others to provide services (such as repairs) in a significant and bona fide sense. Management decisions that may count as active participation include:

- Approving new tenants,
- Deciding on rental terms,
- Approving capital or repair expenditures, and
- Other similar decisions.

The maximum special allowance is:

- \$25,000 for single individuals and married individuals filing a joint return for the tax year.
- \$12,500 for married individuals who file separate returns for the tax year and who lived apart from their spouses at all times during the tax year.
- \$25,000 for a qualifying estate reduced by the special allowance for which the surviving spouse qualified.

Modified adjusted gross income limitation. If your modified adjusted gross income (defined in the instructions for line 10 on page 10) is \$100,000 or less (\$50,000 or less if married filing separately), figure your credits based on the amount of the maximum special allowance referred to in the preceding paragraph.

If your modified adjusted gross income is more than \$100,000 (\$50,000 if married filing separately) but less than \$150,000 (\$75,000 if married filing separately), your special allowance is limited to 50% of the difference between \$150,000 (\$75,000 if married filing separately) and your modified adjusted gross income.

Generally, if your modified adjusted gross income is \$150,000 or more (\$75,000 or more if married filing separately), there is no special allowance.

However, for low-income housing credits for property placed in service before 1990 and for rehabilitation credits, the limits on modified adjusted gross income are increased. If your modified adjusted gross income is more than \$200,000 (\$100,000 if married filing separately) but less than \$250,000 (\$125,000 if married filing separately), your special allowance is limited to 50% of the difference between \$250,000 (\$125,000 if married filing separately) and your modified adjusted gross income.

If your modified adjusted gross income is \$250,000 or more (\$125,000 or more if married filing separately), there is no special allowance.

No modified adjusted gross income limitation applies when figuring the special allowance for low-income housing credits for property placed in service after 1989 (other than from a pass-through entity in which you acquired your interest before 1990).

Trade or Business Activities

A trade or business activity is an activity (other than a rental activity or an activity treated as incidental to an activity of holding property for investment) that:

1. Involves the conduct of a trade or business (within the meaning of section 162),
2. Is conducted in anticipation of starting a trade or business, or
3. Involves research or experimental expenditures deductible under section 174 (or that would be if you chose to deduct rather than capitalize them).

Reporting Credits From the Activities

Trade or business activities with material participation. If you materially participated in a trade or business activity, the activity is not a passive activity. Report the credits from the activity on the forms you normally use.

Trade or business activities without material participation. If you did not materially participate in a trade or business activity, the activity is a passive activity. Generally, you must use Worksheet 4 on page 9 to figure the amount to enter on Form 8582-CR for each trade or business activity in which you did not materially participate. However, if you held the activity through a PTP, special rules apply. See *Publicly Traded Partnerships (PTPs)* on page 14.

Material Participation

For the material participation tests that follow, participation generally includes any work done in connection with an activity if you owned an interest in the activity at the time you did the work. The capacity in which you did the work does not matter. However, work is not participation if:

- It is not work that an owner would customarily do in the same type of activity, and
- One of your main reasons for doing the work was to avoid the disallowance of losses or credits from the activity under the passive activity rules.

Proof of participation. You may prove your participation in an activity by any reasonable means. You do not have to maintain contemporaneous daily time reports, logs, or similar documents if you can establish your participation by other reasonable means. For this purpose, reasonable means include, but are not limited to, identifying services performed over a period of time and the approximate number of hours spent performing the services during that period, based on appointment books, calendars, or narrative summaries.

Tests for individuals. You materially participated for the tax year in an activity if you satisfy at least one of the following tests.

1. You participated in the activity for more than 500 hours.
2. Your participation in the activity for the tax year was substantially all of the participation in the activity of all individuals (including individuals who did not own any interest in the activity) for the year.
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 for the tax year, and you participated in all significant participation activities during the year 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 fourth test).

5. You materially participated in the activity for any 5 (whether or not consecutive) of the 10 immediately preceding tax years.

6. The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years.

An activity is a personal service activity if it involves the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or in any other trade or business in which capital is not a material income-producing factor.

7. Based on all the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis during the tax year.

You did not materially participate in the activity under this seventh test, however, if you participated in the activity for 100 hours or less during the tax year.

Your participation in managing the activity does not count in determining whether you materially participated under this test if:

a. Any person (except you) received compensation for performing services in the management of the activity, or

b. Any individual spent more hours during the tax year performing services in the management of the activity than you did (regardless of whether the individual was compensated for the management services).

Test for a spouse. Participation by your spouse during the tax year in an activity you own may be counted as your participation in the activity, even if your spouse did not own an interest in the activity and whether or not you and your spouse file a joint return for the tax year.

Test for investors. Work done as an investor in an activity is not treated as participation unless you were directly involved in the day-to-day management or operations of the activity. For purposes of this test, work 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 nonmanagerial capacity.

Special rules for limited partners.

If you were a limited partner in an activity, you generally did not materially participate in the activity. You did materially participate in the activity, however, if you met material participation test 1, 5, or 6 (see *Tests for individuals* beginning on page 3) for the tax year.

However, for purposes of the material participation tests, you are not treated as a limited partner if you also were a general partner in the partnership at all times during the partnership's tax year ending with or within your tax year (or, if shorter, during the portion of the partnership's tax year in which you directly or indirectly owned your limited partner interest).

A limited partner's share of an electing large partnership's taxable income or loss from all trade or business and rental activities is treated as income or loss from the conduct of a single passive trade or business activity.

Special rules for certain retired or disabled farmers and surviving spouses of farmers.

Certain retired or disabled farmers and surviving spouses of farmers 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. See Temporary Regulations section 1.469-5T(h)(2).

Estates and trusts. The PAC limitations apply to an estate or trust. See Temporary Regulations sections 1.469-1T(b)(2) and (3). The rules for determining material participation for this purpose have not yet been issued.

Grouping of Activities

Generally, one or more trade or business activities or rental activities may be treated as a single activity if the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules.

Whether activities make up an appropriate economic unit depends on all the relevant facts and circumstances. The factors given the greatest weight in determining whether activities make up an appropriate economic unit are:

1. Similarities and differences in types of trades or businesses,
2. The extent of common control,
3. The extent of common ownership,
4. Geographical location, and

5. Interdependencies between or among the activities.

Example. You have a significant ownership interest in a bakery and a movie theater in Baltimore and in a bakery and a movie theater in Philadelphia. Depending on all the relevant facts and circumstances, there may be more than one reasonable method for grouping your activities. For instance, the following groupings may or may not be permissible.

- A single activity.
- A movie theater activity and a bakery activity.
- A Baltimore activity and a Philadelphia activity.
- Four separate activities.

Once you choose a grouping under these rules, you must continue using that grouping in later tax years unless a material change in the facts and circumstances makes it clearly inappropriate.

The IRS may regroup your activities if your grouping fails to reflect one or more appropriate economic units and one of the primary purposes of your grouping is to avoid the passive activity limitations.

Limitation on grouping certain activities. The following activities may not be grouped together.

1. A rental activity with a trade or business activity unless the activities being grouped together make up an appropriate economic unit and:

a. The rental activity is insubstantial relative to the trade or business activity or vice versa, or

b. Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity. If so, the portion of the rental activity involving the rental of property used in the trade or business activity may be grouped with the trade or business activity.

2. An activity involving the rental of real property with an activity involving the rental of personal property (except personal property provided in connection with the real property or vice versa).

3. Any activity with another activity in a different type of business and in which you hold an interest as a limited partner or as a limited entrepreneur (as defined in section 464(e)(2)), if that other activity engages in holding, producing, or distributing motion picture films or videotapes; farming; leasing section 1245 property; or exploring for (or exploiting) oil and gas resources or geothermal deposits.

Activities conducted through partnerships, S corporations, and C corporations subject to section 469.

Once a partnership or corporation determines its activities under these rules, a partner or shareholder may use these rules to group those activities with:

- Each other,
- Activities conducted directly by the partner or shareholder, or
- Activities conducted through other partnerships and corporations.

A partner or shareholder may not treat as separate activities those activities grouped together by the partnership or corporation.

Partial disposition of an activity.

You may treat the disposition of substantially all of an activity as a separate activity if you can prove with reasonable certainty:

1. The prior year unallowed losses, if any, allocable to the part of the activity disposed of, and
2. The net income or loss for the year of disposition allocable to the part of the activity disposed of.

Disclosure Requirement

For tax years beginning after January 24, 2010, the following disclosure requirements for groupings apply. You are required to report certain changes to your groupings that occur during the tax year to the IRS. If you fail to report these changes, each trade or business activity or rental activity will be treated as a separate activity. You will be considered to have made a timely disclosure if you filed all affected income tax returns consistent with the claimed grouping and make the required disclosure on the income tax return for the year in which you first discovered the failure to disclose. If the IRS discovered the failure to disclose, you must have reasonable cause for not making the required disclosure. For more information on disclosure requirements, see Revenue Procedure 2010-13 available at www.irs.gov/irb/2010-04_IRB/ar15.html.

New grouping. You must file a written statement with your original

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

Addition to an existing grouping.

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

Regrouping. You must file a written statement with your original income tax return for the tax year in which you regroup the activities. The statement must provide the names, addresses, and EINs, if applicable, for the activities that are being regrouped. If two or more activities are being regrouped into a single activity, the statement must contain a declaration that the regrouped activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules. In addition, the statement must contain an explanation of the material change in the facts and circumstances that made the original grouping clearly inappropriate.

Dispositions

Unallowed PACs, unlike unallowed passive activity losses, are not allowed when you dispose of your interest in an activity. However, you may elect to increase the basis of the credit property by the amount of the

original basis reduction of the property to the extent that the credit has not been allowed under the passive activity rules. Unallowed PACs that are not used to increase the basis of the credit property are carried forward until they are allowed. To make the election, complete Form 8582-CR, Part VI. No basis adjustment may be elected on a partial disposition of your interest in a passive activity.

Example of How To Complete Form 8582-CR

For tax years beginning after 2010, line numbers on the referenced forms may change. See the form instructions for the referenced forms on how to report the passive activity credit.

In 2010, John Jones purchased an interest as a limited partner in Partnership A. Mr. Jones is married and files a joint return. During 2010, the partnership placed in service a residential rental building that qualified for the low-income housing credit.

- Mr. Jones received a Schedule K-1 (Form 1065) from the partnership. The low-income housing credit (\$12,000) is shown on Schedule K-1, box 15 with code D.
- Mr. Jones' net passive income for 2010 is zero.
- Mr. Jones will need the following forms to figure the low-income housing credit.

1. **Form 8586**, Low-Income Housing Credit (not illustrated).
2. **Form 8582-CR**, Passive Activity Credit Limitations.

Step 1. Mr. Jones follows the instructions for code D on Schedule K-1, box 15, and enters the \$12,000 low-income housing credit on line 11 of Form 8586.

Step 2. Line 15 of Form 8586 asks for the passive activity low-income housing credit for 2010. The amount is figured on Form 8582-CR and the worksheets. Worksheet 3 of Form 8582-CR is used for the post-1989 low-income housing credits.

Worksheet 3 for Lines 3a and 3b

(keep for your records)

Name of Activity	From Form	Current Year Credits	Prior Year Unallowed Credits	Total Credits
		(a) Credit line 3a	(b) Credit line 3b	(c) Add cols. (a) and (b)
Partnership A	8586	12,000		
Total. Enter on lines 3a and 3b of Form 8582-CR . . . ▶		12,000		

Step 3. Mr. Jones follows the instructions for Worksheet 3 and enters the total credits from column (a) of that worksheet on Form 8582-CR, line 3a. He enters the total credits on line 3c and completes lines 5 through 7. Mr. Jones can skip Parts II and III and go to Part IV because the only credit he has is from a post-1989 low-income housing credit. He must also complete the computation for line 35 in the instructions to get the amount to enter on line 35 of the form (see page 7).

Form 8582-CR (Rev. December 2009) Department of the Treasury Internal Revenue Service	Passive Activity Credit Limitations ▶ See separate instructions. ▶ Attach to Form 1040 or 1041.	OMB No. 1545-1034 Attachment Sequence No. 89
Name(s) shown on return John and Mary Jones		Identifying number 123-00-4567

Part I Passive Activity Credits
Caution: If you have credits from a publicly traded partnership, see **Publicly Traded Partnerships (PTPs)** on page 14 of the instructions.

Credits From Rental Real Estate Activities With Active Participation (Other Than Rehabilitation Credits and Low-Income Housing Credits) (See Lines 1a through 1c on page 9.)				
1a Credits from Worksheet 1, column (a)	1a			
b Prior year unallowed credits from Worksheet 1, column (b)	1b			
c Add lines 1a and 1b			1c	
Rehabilitation Credits From Rental Real Estate Activities and Low-Income Housing Credits for Property Placed in Service Before 1990 (or From Pass-Through Interests Acquired Before 1990) (See Lines 2a through 2c on page 9.)				
2a Credits from Worksheet 2, column (a)	2a			
b Prior year unallowed credits from Worksheet 2, column (b)	2b			
c Add lines 2a and 2b			2c	
Low-Income Housing Credits for Property Placed in Service After 1989 (See Lines 3a through 3c on page 9.)				
3a Credits from Worksheet 3, column (a)	3a	12,000		
b Prior year unallowed credits from Worksheet 3, column (b)	3b			
c Add lines 3a and 3b			3c	12,000
All Other Passive Activity Credits (See Lines 4a through 4c on page 10.)				
4a Credits from Worksheet 4, column (a)	4a			
b Prior year unallowed credits from Worksheet 4, column (b)	4b			
c Add lines 4a and 4b			4c	
5 Add lines 1c, 2c, 3c, and 4c			5	12,000
6 Enter the tax attributable to net passive income (see page 10)			6	-0-
7 Subtract line 6 from line 5. If line 6 is more than or equal to line 5, enter -0- and see page 10			7	12,000
Note: If your filing status is married filing separately and you lived with your spouse at any time during the year, do not complete Part II, III, or IV. Instead, go to line 37.				

Part IV Special Allowance for Low-Income Housing Credits for Property Placed in Service After 1989
Note: Complete this part only if you have an amount on line 3c. Otherwise, go to Part V.

31 If you completed Part III, enter the amount from line 19. Otherwise, subtract line 16 from line 7	31	12,000	
32 Enter the amount from line 30	32	-0-	
33 Subtract line 32 from line 31. If zero, enter -0- here and on line 36	33	12,000	
34 Enter the smaller of line 3c or line 33	34	12,000	
35 Tax attributable to the remaining special allowance (see page 13)	35	8,250	
36 Enter the smaller of line 34 or line 35	36	8,250	

Line 35 computation:

Line 35. Figure the tax attributable to the remaining special allowance as follows:

A. Taxable income	<u>305,000</u>
B. Tax on line A. For Form 1040, use the Tax Table, Tax Computation Worksheet, or other appropriate method you used to figure your tax. For Form 1041, use the Tax Rate Schedules, the Qualified Dividends Tax Worksheet, or Schedule D whichever applies.	<u>78,431</u>
C. Enter \$25,000 (\$12,500 if married filing separate return and you and your spouse lived apart at all times during the year)	<u>25,000</u>
D. Enter amount, if any, from Form 8582, line 10	<u>-0-</u>
E. Enter amount, if any, from Form 8582, line 14	<u>-0-</u>
F. Subtract lines D and E from line C	<u>25,000</u>
G. Subtract line F from line A	<u>280,000</u>
H. Tax on line G. For Form 1040, use the Tax Table, Tax Computation Worksheet, or other appropriate method you used to figure your tax. For Form 1041, use the Tax Rate Schedules, the Qualified Dividends Tax Worksheet, or Schedule D whichever applies.	<u>70,181</u>
I. Subtract line H from line B	<u>8,250</u>
J. Add lines 16 and 30 of Form 8582-CR and enter the total	<u>-0-</u>
K. Tax attributable to the remaining special allowance. Subtract line J from line I. Enter the result on Form 8582-CR, line 35	<u>8,250</u>

Note: When using taxable income in the above computation, it is not necessary to refigure items that are based on a percentage of adjusted gross income.

Step 4. Mr. Jones completes Form 8582-CR, Part V.

Part V Passive Activity Credit Allowed

37 Passive Activity Credit Allowed. Add lines 6, 16, 30, and 36. See page 13 to find out how to report the allowed credit on your tax return and how to allocate allowed and unallowed credits if you have more than one credit or credits from more than one activity. If you have any credits from a publicly traded partnership, see Publicly Traded Partnerships (PTPs) on page 14	37	8,250
--	-----------	-------

Step 5. After completing Form 8582-CR, Mr. Jones determines his allowed and unallowed credit. Because he has only one type of credit from a single passive activity, his allowed low-income housing credit for 2010 is the amount on line 37, or \$8,250. His unallowed credit of \$3,750 is determined by subtracting the allowed credit on line 37 from the total credit on line 5 (\$12,000 – \$8,250).

Step 6. Mr. Jones enters the allowed passive activity credit of \$8,250 on Form 8586, line 15, and completes Part II of that form according to the instructions for Form 8586. The unallowed credit of \$3,750 is carried forward and used to figure the passive activity credit allowed for 2011.

Specific Instructions

Current Year Credits

Convert any current year qualified expenditures into credits before beginning Worksheet 1, 2, 3, or 4. If the credits are from more than one activity or are of more than one type, separate the credits by activity and by type before making entries in the worksheets.



For tax years beginning after 2010, line numbers on the referenced forms may change. See the form instructions for the referenced forms on how to report the current year passive activity credit.

Example. You have a low-income housing credit from one activity and a research credit from a different activity. Enter the low-income housing credit in column (a) of Worksheet 2 or 3 and make a separate entry for the research credit in column (a) of Worksheet 4.

Form 3468, Investment Credit. Enter the credits from Form 3468, line 15, in column (a) of Worksheet 1, 2, or 4.

Form 3800, General Business Credit. Enter the credits from Form 3800, line 3, in column (a) of Worksheet 1, 2, 3, or 4.

Form 5884, Work Opportunity Credit. Enter the credits from Form 5884, line 5, in column (a) of Worksheet 1 or 4.

Form 6478, Alcohol and Cellulosic Biofuels Fuels Credit. Enter the credits from Form 6478, line 10, in column (a) of Worksheet 1 or 4.

Form 8586, Low-Income Housing Credit. Enter the credits from Form 8586, line 13, in column (a) of Worksheet 3.

Form 8834, Qualified Plug-In Electric and Electric Vehicle Credit. See the Instructions for Form 8834 for the amount to enter in column (a) of Worksheet 1 or 4.

Form 8835, Renewable Electricity, Refined Coal, and Indian Coal

Production Credit. Enter the credits from Form 8835, line 31, in column (a) of Worksheet 1 or 4.

Form 8844, Empowerment Zone and Renewal Community Employment Credit. Enter the credits from Form 8844, line 5, in column (a) of Worksheet 1 or 4.

Form 8846, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips. Enter the credits from Form 8846, line 7, in column (a) of Worksheet 4.

Form 8941, Credit for Small Employer Health Insurance Premiums. Enter the credits from Form 8941, line 17, in column (a) of Worksheet 4.

Prior Year Unallowed Credits

To figure this year's PAC, you must take into account any credits from passive activities disallowed for prior years and carried forward to this year.

Lines 1a and 1b. Use Worksheet 1 to figure the amounts to enter on lines 1a and 1b. Use line 1a for credits from rental real estate activities with active participation for the current year and line 1b for prior year unallowed credits from rental real estate activities with active participation in both the prior year in which the credit arose and the current year. See *Special Allowance for Rental Real Estate Activities* on page 2 for a definition of active participation.

After you complete the worksheet below, enter the totals of columns (a) and (b) on the corresponding lines of Form 8582-CR and then complete line 1c.

Note. Rehabilitation credits from rental real estate activities and low-income housing credits must be entered in Worksheet 2 or 3, whichever applies, even if you actively participated in the activity.

Worksheet 1 for Lines 1a and 1b

(keep for your records)

Name of Activity	From Form	Current Year Credits	Prior Year Unallowed Credits	Total Credits
		(a) Credit line 1a	(b) Credit line 1b	(c) Add cols. (a) and (b)
Totals. Enter on lines 1a and 1b of Form 8582-CR . . . ▶				

Lines 2a and 2b. Use Worksheet 2 to figure the amounts to enter on lines 2a and 2b. Use line 2a for rehabilitation credits and low-income housing credits from rental real estate activities for the current year and line 2b for prior year unallowed credits from those activities. However, use Worksheet 3 instead of Worksheet 2 for low-income housing credits for 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, use Worksheet 3 only if you also acquired your interest in the pass-through entity after 1989. Use this worksheet if you do not meet both requirements.

After you complete the worksheet below, enter the totals of columns (a) and (b) on the corresponding lines of Form 8582-CR and then complete line 2c.

Worksheet 2 for Lines 2a and 2b

(keep for your records)

Name of Activity	From Form	Current Year Credits	Prior Year Unallowed Credits	Total Credits
		(a) Credit line 2a	(b) Credit line 2b	(c) Add cols. (a) and (b)
Totals. Enter on lines 2a and 2b of Form 8582-CR . . . ▶				

Lines 3a and 3b. Use Worksheet 3 to figure the amounts to enter on lines 3a and 3b for low-income housing credits for 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, use Worksheet 3 only if you also acquired your interest in the pass-through entity after 1989. Use line 3a for the current year credits and line 3b for prior year unallowed credits for those activities.

After you complete the worksheet below, enter the totals of columns (a) and (b) on the corresponding lines of Form 8582-CR and then complete line 3c.

Worksheet 3 for Lines 3a and 3b

(keep for your records)

Name of Activity	From Form	Current Year Credits	Prior Year Unallowed Credits	Total Credits
		(a) Credit line 3a	(b) Credit line 3b	(c) Add cols. (a) and (b)
Totals. Enter on lines 3a and 3b of Form 8582-CR . . . ▶				

Lines 4a and 4b. Use Worksheet 4 to figure the amounts to enter on lines 4a and 4b. Use line 4a for all other passive activity credits for the current year and line 4b for prior year unallowed credits from those activities.

After you complete the worksheet below, enter the totals of columns (a) and (b) on the corresponding lines of Form 8582-CR and then complete line 4c.


Worksheet 4 for Lines 4a and 4b

(keep for your records)

Name of Activity	From Form	Current Year Credits	Prior Year Unallowed Credits	Total Credits
		(a) Credit line 4a	(b) Credit line 4b	(c) Add cols. (a) and (b)
Totals. Enter on lines 4a and 4b of Form 8582-CR . . . ▶				

If you had only one type of prior year unallowed credit from a single passive activity, figure your prior year unallowed credit by subtracting line 37 of your prior year Form 8582-CR from line 5 of your prior year Form 8582-CR.

Otherwise, your prior year unallowed credits are the amounts shown in column (b) of Worksheet 9 in the prior year Instructions for Form 8582-CR. Enter the prior year unallowed credits in column (b) of Worksheet 1, 2, 3, or 4, whichever applies.

 *You must adjust a prior year unallowed credit if you had to recapture any part of the credit (for example, due to the early disposition of property) or transfer the credit to a bankruptcy estate.*

Part I—Passive Activity Credits


Use Part I to combine your credits from passive activities to determine if you have a PAC for the current year.

If your credits from all passive activities exceed the tax attributable

to net passive income, you have a PAC for the current year. Generally, you have net passive income if line 4 of Form 8582 shows income. For more information, see the instructions for Form 8582-CR, line 6, on page 10.

Lines 1a through 1c. Individuals and qualifying estates that actively participated in rental real estate activities must include the credits (other than rehabilitation credits or low-income housing credits) from these activities on lines 1a through 1c. Use Worksheet 1 to figure the amounts to enter on lines 1a and 1b.

See *Special Allowance for Rental Real Estate Activities* beginning on page 2.

 *If you are married filing a separate return and lived with your spouse at any time during the year, even if you actively participated in the rental real estate activity, include the credits in Worksheet 4, not in Worksheet 1.*

Note. You may take credits that arose in a prior tax year (other than low-income housing and rehabilitation credits) under the special allowance only if you actively participated in the

rental real estate activity for both that prior year and this year. If you did not actively participate for both years, include the credits in Worksheet 4, not in Worksheet 1.

Lines 2a through 2c. Individuals (including limited partners) and qualifying estates who had rehabilitation credits from rental real estate activities or low-income housing credits for property placed in service before 1990 must include the credits from those activities on lines 2a through 2c. Use Worksheet 2 to figure the amounts to enter on lines 2a and 2b.

If you have low-income housing credits for property placed in service after 1989, include those credits in Worksheet 3 instead of Worksheet 2. If you held an indirect interest in the property through a partnership, S corporation, or other pass-through entity, use Worksheet 3 only if you also acquired your interest in the pass-through entity after 1989.

Lines 3a through 3c. Individuals (including limited partners) and qualifying estates who had low-income housing credits from rental real estate activities for property placed in service after 1989

must include those credits on lines 3a through 3c. If you held an indirect interest in the property through a partnership, S corporation, or other pass-through entity, use lines 3a through 3c only if you also acquired your interest in the pass-through entity after 1989. Use Worksheet 3 to figure the amounts to enter on lines 3a and 3b.



CAUTION Include the credits in Worksheet 4, but not in Worksheet 2 or 3, if you are married filing a separate return and lived with your spouse at any time during the year.

Lines 4a through 4c. Individuals must include on lines 4a through 4c credits from passive activities that were not entered on Worksheets 1, 2, or 3. Trusts must include credits from all passive activities in Worksheet 4. Use Worksheet 4 to figure the amounts to enter on lines 4a and 4b.

Line 6. If Form 8582, line 4, shows net income or you did not complete Form 8582 because you had net passive income, you must figure the tax on the net passive income. If you have an overall loss on an entire disposition of your interest in a passive activity, reduce net passive income, if any, on Form 8582, line 4, to the extent of the loss (but not below zero) and use only the remaining net passive income in the computation below. If you had a net passive activity loss, enter -0- on line 6 and go to line 7.

Figure the tax on net passive income as follows.

A. Taxable income including net passive income	_____
B. Tax on line A*	_____
C. Taxable income without net passive income	_____
D. Tax on line C*	_____
E. Subtract line D from line B and enter the result on Form 8582-CR, line 6	_____

* For Form 1040, use the Tax Table, Tax Computation Worksheet, or other appropriate method you used to figure your tax. For Form 1041, use the Tax Rate Schedule, Qualified Dividends Tax Worksheet, or Schedule D, whichever applies.

Note. When using taxable income in the above computation, it is not necessary to refigure items that are based on a percentage of adjusted gross income.

Line 7. If line 7 is zero because the tax on the net passive income on line 6 is greater than your credits from passive activities on line 5, all your credits from passive activities are allowed. In this case, enter the

amount from line 5 on line 37 and report the credits on the forms normally used. Do not complete Worksheets 5 through 9.

Part II—Special Allowance for Rental Real Estate Activities With Active Participation



CAUTION Married persons filing separate returns who lived with their spouses at any time during the year are not eligible to complete Part II.

Use Part II to figure the credit allowed if you have any credits from rental real estate activities in which you actively participated (other than rehabilitation credits and low-income housing credits). See *Rental Activities* beginning on page 1 for details.

Line 9. Married persons filing separate returns who lived apart from their spouses at all times during the year must enter \$75,000 on line 9 instead of \$150,000. Married persons filing separate returns who lived with their spouses at any time during the year are not eligible for the special allowance. They must enter -0- on line 16 and go to line 17.

Line 10. To figure modified adjusted gross income, combine all the amounts used to figure adjusted gross income except do not take into account:

- Any passive activity loss as defined in section 469(d)(1),
- Any rental real estate loss allowed to real estate professionals (defined under *Activities That Are Not Passive Activities* on page 1),
- Any overall loss from a PTP,
- The taxable amount of social security and tier 1 railroad retirement benefits,
- Deductible contributions to traditional individual retirement accounts (IRAs) and section 501(c)(18) pension plans,
- The domestic production activities deduction,
- The deduction allowed for one-half of self-employment taxes,
- The exclusion from income of interest from series EE and I U.S. savings bonds used to pay higher education expenses,
- The exclusion of amounts received under an employer's adoption assistance program,
- The student loan interest deduction, or

- The tuition and fees deduction.

Include in modified adjusted gross income any portfolio income and expenses that are clearly and directly allocable to portfolio income. Also include any income that is treated as nonpassive income, such as overall gain from a PTP and net income from an activity or item of property subject to the recharacterization of passive income rules. For information on recharacterization of income, see Pub. 925 or Temporary Regulations section 1.469-2T(f).

When figuring modified adjusted gross income, any overall loss from an entire disposition of an interest in a passive activity is taken into account as a nonpassive loss if you do not have any net passive income after combining net income and losses from all other passive activities (that is, Form 8582, line 4 is a loss or zero). If you do have net passive income when you combine the net losses and net income from all other passive activities, the overall loss from the disposition is taken into account as a nonpassive loss only to the extent that it exceeds that net passive income.

Line 12. Do not enter more than \$12,500 on line 12 if you are married filing a separate return and you and your spouse lived apart at all times during the year. Married persons filing separate returns who lived with their spouses at any time during the year are not eligible for the special allowance. They must enter -0- on line 16 and go to line 17.

Line 15. Figure the tax attributable to the amount on line 14 as follows.

A. Taxable income	_____
B. Tax on line A*	_____
C. Enter amount from Form 8582-CR, line 14	_____
D. Subtract line C from line A	_____
E. Tax on line D*	_____
F. Subtract line E from line B and enter the result on Form 8582-CR, line 15	_____

* For Form 1040, use the Tax Table, Tax Computation Worksheet, or other appropriate method you used to figure your tax. For Form 1041, use the Tax Rate Schedule, Qualified Dividends Tax Worksheet, or Schedule D, whichever applies.

Note. When using taxable income in the above computation, it is not necessary to refigure items that are based on a percentage of adjusted gross income.

Instructions for Worksheet 5

Complete Worksheet 5 if you have an amount on Form 8582-CR, line 1c and you have credits from more than one activity.

Column (a). Enter the credits from Worksheet 1, column (c), in column (a) of this worksheet.

Column (b). Divide each of the credits shown in column (a) by the total of the credits in column (a) and enter the ratio for each of the activities in column (b). The total of all the ratios must equal 1.00.

Column (c). Multiply Form 8582-CR, line 16 by the ratios in column (b) and enter the result in column (c). If the total of this column is the same as the total of column (a), all credits for the activities in column (a) of this worksheet are allowed. Report them on the forms normally used, and complete Worksheet 6 if you have credits shown in Worksheet 2. Also complete Worksheet 7 or 8 if you have credits shown in Worksheet 3 or 4. If the total of column (a) is more than the total of column (c), complete column (d).

Column (d). Subtract column (c) from column (a) and enter the result in this column. Also enter the name of each activity and the form the credit is reported on in Worksheet 8 and enter the amount from column (d) of this worksheet in column (a) of Worksheet 8. Also complete Worksheet 6 or 7 if you have credits on Form 8582-CR, line 2c or 3c.

Worksheet 5 for Credits on Line 1a or 1b

(keep for your records)

Name of Activity	Form To Be Reported on	(a) Credits	(b) Ratios	(c) Special Allowance	(d) Subtract column (c) from column (a)
Totals ▶			1.00		

Instructions for Worksheet 6

Complete Worksheet 6 if you have an amount on Form 8582-CR, line 2c and you have credits from more than one activity.

Column (a). Enter the credits from Worksheet 2, column (c), in column (a) of this worksheet.

Column (b). Divide each of the credits shown in column (a) by the total of the credits in column (a) and enter the ratio for each of the activities in column (b). The total of all the ratios must equal 1.00.

Column (c). Multiply Form 8582-CR, line 30 by the ratios in column (b) and enter the result in column (c). If the total of this column is the same as the total of column (a), all credits for the activities in column (a) of this worksheet are allowed. Report them on the forms normally used, and complete Worksheet 7 or 8 if you have credits shown in Worksheet 3 or 4 or amounts in column (d) of Worksheet 5. If the total of column (a) is more than the total of column (c), complete column (d).

Column (d). Subtract column (c) from column (a) and enter the result in this column. Also enter the name of each activity and the form the credit is reported on in Worksheet 8 and enter the amount from column (d) of this worksheet in column (a) of Worksheet 8.

Worksheet 6 for Credits on Line 2a or 2b

(keep for your records)

Name of Activity	Form To Be Reported on	(a) Credits	(b) Ratios	(c) Special Allowance	(d) Subtract column (c) from column (a)
Totals ▶			1.00		

Instructions for Worksheet 7

Complete Worksheet 7 if you have credits on Form 8582-CR, line 3c and you have credits from more than one activity.

Column (a). Enter the credits from Worksheet 3, column (c), in column (a) of this worksheet.

Column (b). Divide each of the credits shown in column (a) by the total of the credits in column (a) and enter the ratio for each of the activities in column (b). The total of all the ratios must equal 1.00.

Column (c). Multiply Form 8582-CR, line 36 by the ratios in column (b) and enter the result in column (c). If the total of this column is the same as the total of column (a), all credits for the activities in column (a) of this worksheet are allowed. Report them on the forms normally used, and complete Worksheet 8 if you have credits shown in Worksheet 4 or amounts in column (d) of Worksheet 5 or 6. If the total of column (a) is more than the total of column (c), complete column (d).

Column (d). Subtract column (c) from column (a) and enter the result in this column. Also enter the name of each activity and the form the credit is reported on in Worksheet 8 and enter the amount from column (d) of this worksheet in column (a) of Worksheet 8.

Worksheet 7 for Credits on Line 3a or 3b

(keep for your records)

Name of Activity	Form To Be Reported on	(a) Credits	(b) Ratios	(c) Special Allowance	(d) Subtract column (c) from column (a)
Totals	▶		1.00		

Instructions for Worksheet 8

Complete Worksheet 8 if you have credits on Form 8582-CR, line 4c from more than one activity or reported on different forms or you have amounts in column (d) of Worksheets 5, 6, or 7.

Column (a). Enter the amounts, if any, from column (c) of Worksheet 4 and column (d) of Worksheets 5, 6, and 7.

Column (b). Divide each of the credits in column (a) by the total of all the credits in column (a) and enter the ratio for each of the activities in column (b). The total of all the ratios must equal 1.00.

Column (c). Complete the following computation:

- A. Enter Form 8582-CR, line 5 _____
- B. Enter Form 8582-CR, line 37 _____
- C. Subtract line B from line A _____

Multiply line C by the ratios in column (b) and enter the results in column (c). Complete Worksheet 9 to determine the credits allowed for the current year.

Worksheet 8—Allocation of Unallowed Credits

(keep for your records)

Name of Activity	Form To Be Reported on	(a) Credits	(b) Ratios	(c) Unallowed Credits
Totals	▶		1.00	

Instructions for Worksheet 9

Column (a). Enter all the activities shown in Worksheet 8. The credits entered in column (a) of this worksheet are the credits shown in column (c) of Worksheets 1, 2, 3, and 4 for the activities listed in Worksheet 8.

Column (b). Enter the amounts from column (c) of Worksheet 8 in this column. These are your unallowed credits for the current year.

Column (c). Subtract column (b) from column (a). These are the allowed credits for the current year. Report the amounts in this column on the forms normally used. See *Reporting Allowed Credits on Your Tax Return* on page 13.

Worksheet 9—Allowed Credits

(keep for your records)

Name of Activity	Form To Be Reported on	(a) Credits	(b) Unallowed Credits	(c) Allowed Credits
Totals	▶			

Part III—Special Allowance for Rehabilitation Credits From Rental Real Estate Activities and Low-Income Housing Credits for Property Placed in Service Before 1990 (or From Pass-Through Interests Acquired Before 1990)



Married persons filing separate returns who lived with their spouses at any time during the year are not eligible to complete Part III.

Use Part III to figure the credit allowed if you have any rehabilitation credits or low-income housing credits for property placed in service before 1990. Also use this part if your low-income housing credit is from a partnership, S corporation, or other pass-through entity in which you acquired your interest before 1990, regardless of the date the property was placed in service.

Line 21. Married persons filing separate returns who lived apart from their spouses at all times during the year must enter \$125,000 on line 21, instead of \$250,000.

Skip lines 21 through 26 if you completed Part II of this form and your modified adjusted gross income on line 10 was \$100,000 or less (\$50,000 or less if married filing separately and you lived apart from your spouse for the entire year). Instead, enter the amount from line 15 on line 27.

Line 24. Do not enter more than \$12,500 on line 24 if you are married filing a separate return and lived apart from your spouse for the entire year.

Line 27. Figure the tax attributable to the amount on line 26 as follows.

A. Taxable income	_____
B. Tax on line A*	_____
C. Enter amount from Form 8582-CR, line 26	_____
D. Subtract line C from line A	_____
E. Tax on line D*	_____
F. Subtract line E from line B and enter the result on Form 8582-CR, line 27	_____

*For Form 1040, use the Tax Table, Tax Computation Worksheet, or other appropriate method you used to figure your tax. For Form 1041, use the Tax Rate Schedule, Qualified Dividends Tax Worksheet, or Schedule D, whichever applies.

Note. When using taxable income in the above computation, it is not necessary to refigure items that are

based on a percentage of adjusted gross income.

Part IV—Special Allowance for Low-Income Housing Credits for Property Placed in Service After 1989



Married persons filing separate returns who lived with their spouses at any time during the year are not eligible to complete Part IV.

Use Part IV to figure the credit allowed if you have any low-income housing credits for 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, use Part IV only if your interest in the pass-through entity was also acquired after 1989.

Line 35. Figure the tax attributable to the remaining special allowance as follows.

A. Taxable income	_____
B. Tax on line A*	_____
C. Enter \$25,000 (\$12,500 if married filing separate return and you and your spouse lived apart at all times during the year)	_____
D. Enter amount, if any, from Form 8582, line 10	_____
E. Enter the amount, if any, from Form 8582, line 14	_____
F. Subtract lines D and E from line C	_____
G. Subtract line F from line A	_____
H. Tax on line G*	_____
I. Subtract line H from line B	_____
J. Add lines 16 and 30 of Form 8582-CR and enter the total	_____
K. Tax attributable to the remaining special allowance. Subtract line J from line I. Enter the result on Form 8582-CR, line 35	_____

*For Form 1040, use the Tax Table, Tax Computation Worksheet, or other appropriate method you used to figure your tax. For Form 1041, use the Tax Rate Schedule, Qualified Dividends Tax Worksheet, or Schedule D, whichever applies.

Note. When using taxable income in the above computation, it is not necessary to refigure items that are based on a percentage of adjusted gross income.

Part V—Passive Activity Credit Allowed

Use Part V to figure the PAC (as determined in Part I) that is allowed for the current year for all passive activities.

Line 37. If you have only one type of credit, the amount on line 37 is the credit allowed for the year. Enter this amount on the form where it is normally reported. See *Reporting Allowed Credits on Your Tax Return* below. Your unallowed credit is line 5 minus line 37.

Use Worksheets 5 through 9, whichever apply, on pages 11 and 12, to allocate the allowed and unallowed credits if you have credits from more than one activity. Also use the worksheets if you have more than one type of credit.

Keep a record of each unallowed credit and the activity to which it belongs so you may claim the credit if it becomes allowable in a future year.

Reporting Allowed Credits on Your Tax Return



For tax years beginning after 2010, line numbers on the referenced forms may change. See the form instructions for the referenced forms on how to report the passive activity credit allowed.

Form 3468. Enter on Form 3468, line 17, the passive activity rehabilitation and energy credits.

Form 3800. Enter on Form 3800, line 5, the total passive activity general business credit allowed.

Form 5884. Enter on Form 5884, line 7, the passive activity work opportunity credit.

Form 6478. Enter on Form 6478, line 12, the passive activity alcohol and cellulosic biofuel fuels credit allowed.

Form 8586. Enter on Form 8586, line 15, the passive activity low-income housing credit allowed.

Form 8834. See the Instructions for Form 8834 for instructions on how to report the passive activity credit allowed.

Form 8835. Enter on Form 8835, line 33, the passive activity renewable electricity, refined coal, and Indian coal production credit allowed.

Form 8844. Enter on Form 8844, line 7, the passive activity empowerment zone and renewal community employment credit allowed.

Form 8846. Enter on Form 8846, line 9, the passive activity credit for employer social security and Medicare taxes paid on certain employee tips.

Form 8941. Enter on Form 8941, line 19, the passive activity credit for small employer health insurance premiums allowed.

Publicly Traded Partnerships (PTPs)

A PTP is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market (or its substantial equivalent).

An established securities market includes any national securities exchange and any local exchange registered under the Securities Exchange Act of 1934 or exempted from registration because of the limited volume of transactions. It also includes any over-the-counter market.

A secondary market generally exists if a person stands ready to make a market in the interest. An interest is treated as readily tradable if the interest is regularly quoted by persons, such as brokers or dealers, who are making a market in the interest.

The substantial equivalent of a secondary market exists if there is no identifiable market maker, but holders of interests have a readily available, regular, and ongoing opportunity to sell or exchange their interests through a public means of obtaining or providing information on offers to buy, sell, or exchange interests. Similarly, the substantial equivalent of a secondary market exists if prospective buyers and sellers have the opportunity to buy, sell, or exchange interests in a timeframe and with the regularity and continuity that the existence of a market maker would provide.

Credits From PTPs

A credit from a passive activity held through a PTP is allowed to the extent of the tax attributable to net passive income from that partnership. In addition, rehabilitation credits and low-income housing credits from rental real estate activities held through PTPs are allowed to the extent of any special allowance that remains after taking into account losses and credits from rental real estate activities not owned through PTPs. See *Special Allowance for Rental Real Estate Activities* beginning on page 2.



Do not enter credits from PTPs on the worksheets or on Form 8582-CR. Instead, use the following steps to figure the allowed and unallowed credits from passive activities held through PTPs.

Computation of Allowed Passive Activity Credits From PTPs

Complete Steps 1 and 2 only if you have net passive income from a PTP with passive activity credits (including prior year unallowed credits).

Step 1. Figure the tax attributable to net passive income from each PTP with passive activity credits (including prior year unallowed credits) by following the steps shown in the worksheet in the line 6 instructions on page 10. Complete a separate tax computation for each PTP with net passive income.

Step 2. Passive activity credits from each PTP are allowed to the extent of the tax attributable to net passive income from the same PTP. Credits in excess of the tax attributable to net passive income may be allowed under one or more steps below.

Complete Steps 3 through 5 only if your passive activity credits (including prior year unallowed credits) include rehabilitation credits from rental real estate activities from PTPs, low-income housing credits for property placed in service before 1990 from PTPs, or low-income housing credits from PTPs in which you acquired your interest before 1990 (regardless of the date placed in service).

Step 3. Reduce rehabilitation credits from rental real estate activities from each PTP, low-income housing credits for property placed in service before 1990 from each PTP, and any low-income housing credits (including prior year unallowed credits) from each PTP in which you acquired your interest before 1990 (regardless of the date placed in service) to the extent of the tax, which was figured in Step 1, attributable to net passive income from that PTP.

Step 4. Before beginning this step, complete Form 8582-CR if you have any passive credits that are not from PTPs. Subtract the total of lines 16, 30, and 36, if any, of Form 8582-CR, from the amount on line 27 of Form 8582-CR, to figure the tax attributable to the special allowance available for the credits in Step 3.

If your only passive credits are from PTPs, complete lines 21 through 27 of Form 8582-CR as a worksheet. The amount on line 27 is the tax attributable to the special allowance available for the credits in Step 3.

Step 5. Rehabilitation credits from rental real estate activities of PTPs, low-income housing credits for property placed in service before 1990 by PTPs, and low-income housing credits from PTPs in which you acquired your interest before 1990 (regardless of the date placed in

service) allowed under the special allowance are the smaller of the total credits from Step 3 or the amount figured in Step 4. If Step 4 is smaller than Step 3, allocate the amount in Step 4 pro rata to the credits from each PTP in Step 3.

Complete Steps 6 through 8 only if you have low-income housing credits (including prior year unallowed credits) for property placed in service after 1989 from a PTP in which you acquired your interest after 1989.

Step 6. Reduce low-income housing credits (including prior year unallowed credits) for property placed in service after 1989 from each PTP in which you also acquired your interest after 1989 to the extent of the tax attributable to net passive income from that PTP, which was figured in Step 1.

Step 7. Before beginning this step, complete Form 8582-CR if you have any passive credits that are not from PTPs. Subtract the sum of the credits allowed in Step 5 above and Form 8582-CR, line 36, from the amount on Form 8582-CR, line 35, to figure the tax attributable to the special allowance available for the credits in Step 6.

If your only passive credits are from PTPs, complete the steps shown in the worksheet in the line 35 instructions on page 13. Subtract the credits allowed in Step 5 above from the tax figured on line K of that worksheet. The result is the tax attributable to the special allowance available for the credits in Step 6.

Step 8. Low-income housing credits allowed under the special allowance for property placed in service after 1989 from a PTP in which you also acquired your interest after 1989 are the smaller of the total credits from Step 6 or the amount figured in Step 7. If Step 7 is smaller than Step 6, allocate the amount in Step 7 pro rata to the credits from each PTP in Step 6.

Step 9. Add the credits from Steps 2, 5, and 8. These are the total credits allowed from passive activities of PTPs.

Step 10. Figure the allowed and unallowed credits from each PTP. Report the allowed credits on the forms normally used. Keep a record of the unallowed credits to be carried forward to next year.

Part VI—Election To Increase Basis of Credit Property

Complete Part VI if you disposed of your entire interest in a passive activity and elect to increase the basis of the credit property used in

the activity by the unallowed credit that reduced the basis of the property.

Line 38. Check the box if you elect to increase the basis of credit property used in a passive activity by the unallowed credit that reduced the property's basis. The election is available for a fully taxable disposition of an entire interest in an activity for which a basis adjustment was made as a result of placing in service property for which a credit was taken. You may elect to increase the basis of the credit property immediately before the disposition (by an amount no greater than the amount of the original basis reduction) to the extent that the credit had not been allowed previously because of the passive activity credit limitations. The amount of the unallowed credit that may be applied against tax is reduced by the amount of the basis adjustment.

No basis adjustment may be elected on a partial disposition of your interest in a passive activity or if the disposition is not fully taxable. The amount of any unallowed credit,

however, remains available to offset the tax attributable to net passive income.

Paperwork Reduction Act Notice.

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on

individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown below.

Recordkeeping	2 hr., 4 min.
Learning about the law or the form	6 hr., 4 min.
Preparing the form	4 hr., 19 min.
Copying, assembling, and sending the form to the IRS	1 hr., 9 min.

If you have suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.



Passive Activity Loss Limitations

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

Commercial revitalization deduction (CRD). CRDs for rental real estate activities are not allowed for buildings placed in service after December 31, 2009. See *Commercial revitalization deduction (CRD)* on page 4.

Disclosure requirements for groupings. For tax years beginning after January 24, 2010, disclosure requirements for groupings of trade or business activities or rental activities apply. See *Disclosure Requirement* on page 5.

General Instructions

Purpose of Form

Form 8582 is used by noncorporate taxpayers to figure the amount of any passive activity loss (PAL) for the current tax year.

A PAL occurs when total losses (including prior year unallowed losses) from all your passive activities exceed the total income from all your passive activities.

Generally, passive activities include:

- Trade or business activities in which you did not materially participate for the tax year.
- Rental activities, regardless of your participation.

PALs cannot be used to offset income from nonpassive activities. However, a special allowance for rental real estate activities may allow some losses even if the losses exceed passive income.

PALs not allowed in the current year are carried forward until they are allowed either against passive activity income, against the special allowance, if applicable, or when you sell or exchange your entire interest in the activity in a fully taxable transaction to an unrelated party.

For more information, see Pub. 925, *Passive Activity and At-Risk Rules*, which contains a filled-in example of Form 8582 with step-by-step instructions for reporting losses from passive activities.

Note. Corporations subject to the passive activity rules must use Form

8810, *Corporate Passive Activity Loss and Credit Limitations*.

Who Must File

Form 8582 is filed by individuals, estates, and trusts who have losses (including prior year unallowed losses) from passive activities. You do not have to file Form 8582 if you meet Exception 1 or 2 below.

Exception 1

You do not have an overall loss when you combine all your net income and net losses (including any prior year unallowed losses) from business or rental passive activities. Overall loss is defined under *Definitions* on page 2.

In figuring your overall gain or loss from all passive activities for the year, do not include the following income or losses.

1. Net income that is not passive activity income. See *Passive Activity Income and Deductions* beginning on page 5.
2. Net losses that are not passive activity net losses. See *Activities That Are Not Passive Activities* on page 2.
3. Net income or net loss from your interest in any publicly traded partnership (PTP). See *Publicly Traded Partnerships (PTPs)* beginning on page 12.
4. Any overall loss from an entire disposition of a passive activity. See *Dispositions* on page 7 for more information.

Exception 2

You actively participated in rental real estate activities (see *Special Allowance for Rental Real Estate Activities* beginning on page 3), and you meet all of the following conditions.

- Rental real estate activities with active participation were your only passive activities.
- You have no prior year unallowed losses from these activities.
- Your total loss from the rental real estate activities was not more than \$25,000 (\$12,500 if married filing separately and you lived apart from your spouse all year).
- If you are married filing separately, you lived apart from your spouse all year.
- You have no current or prior year unallowed credits from a passive activity.

- Your modified adjusted gross income was not more than \$100,000 (not more than \$50,000 if married filing separately and you lived apart from your spouse all year).
- You do not hold any interest in a rental real estate activity as a limited partner or as a beneficiary of an estate or a trust.

For the definition of modified adjusted gross income, see the instructions for line 7 on page 9.

If all the above conditions are met, your rental real estate losses are not limited, and you do not need to complete Form 8582. Enter losses reported on Schedule E (Form 1040), Supplemental Income and Loss, Part I, line 22, on Schedule E (Form 1040), Part I, line 23. For losses from a partnership or an S corporation, enter the amount of the allowable loss from Schedule K-1 in Schedule E (Form 1040), Part II, column (f). Enter losses reported on line 32 of Form 4835, *Farm Rental Income and Expenses*, on Form 4835, line 33c.

Coordination With Other Limitations

Generally, PALs are subject to other limitations (for example, basis and at-risk limitations) before they are subject to the passive loss limitations. Once a loss becomes allowable under these other limitations, you must determine whether the loss is limited under the passive loss rules. See Form 6198, *At-Risk Limitations*, for details on the at-risk rules. Also, capital losses that are allowable under the passive loss rules may be limited under the capital loss limitations of section 1211. Percentage depletion deductions that are allowable under the passive loss rules may be limited under section 613A(d).

Before Completing Form 8582

To find out if your activity is treated as a passive activity, read the following sections of these instructions.

- *Trade or Business Activities* if your activity is a trade or business activity (page 3).
- *Rental Activities* if your activity is the renting of tangible property (page 2).
- *Material Participation* (page 4).
- *Grouping of Activities* (page 5).

To find out how to treat income and deductions from your activity, read *Passive Activity Income and Deductions, Former Passive Activities, and Dispositions* (pages 5 through 8).

To find out how to enter income and losses on Form 8582, read the instructions for Worksheets 1, 2, and 3 (on page 8).

Definitions

Except as otherwise indicated, the following terms in these instructions are defined as shown below.

Net income. This is the excess of current year income over current year deductions from the activity. This includes any current year gains or losses from the disposition of assets or an interest in the activity.

Net loss. This is the excess of current year deductions over current year income from the activity. This includes any current year gains or losses from the disposition of assets or an interest in the activity.

Overall gain. This is the excess of the "net income" from the activity over the prior year unallowed losses from the activity.

Overall loss. This is (a) the excess of the prior year unallowed losses from the activity over the "net income" from the activity or (b) the prior year unallowed losses from the activity plus the "net loss" from the activity.

Prior year unallowed losses. These are the losses from an activity that were disallowed under the PAL limitations in a prior year and carried forward to the tax year under section 469(b). See Regulations section 1.469-1(f)(4) and Pub. 925.

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. Any rental real estate activity in which you materially participated if you were a "real estate professional" for the tax year. You were a real estate professional only if:

a. More than half of the personal services you performed in trades or businesses during the tax year were performed in real property trades or businesses in which you materially participated, and

b. You performed more than 750 hours of services during the tax year in real property trades or businesses in which you materially participated.

For purposes of item (2), each interest in rental real estate is a separate activity, unless you elect to treat all interests in rental real estate as

one activity. For details on making this election, see page E-2 of the instructions for Schedule E (Form 1040).

If you are married filing jointly, one spouse must separately meet both (2)(a) and (2)(b), without taking into account services performed by the other spouse.

A real property trade or business is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

Services you performed as an employee are not treated as performed in a real property trade or business unless you owned more than 5% of the stock (or more than 5% of the capital or profits interest) in the employer.

Note. If a rental real estate activity is not a passive activity for the current year, any prior year unallowed loss is treated as a loss from a former passive activity. See *Former Passive Activities* on page 7.

3. 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). In this case, it does not matter whether you materially participated in the activity for the tax year.

If, however, 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).

4. 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 unit that you also used as a home during the year for a number of days that exceeds the greater of 14 days or 10% of the number of days during the year that the home was rented at a fair rental.

5. An activity of trading personal property for the account of owners of interests in the activity. For purposes of this rule, personal property means property that is actively traded, such as stocks, bonds, and other securities. See Temporary Regulations section 1.469-1T(e)(6) for more details.

Generally, income and losses from these activities are not entered on Form 8582. However, losses from these activities may be subject to limitations other than the passive loss rules.

Rental Activities

A rental activity is a passive activity even if you materially participated in the activity (unless it is a rental real estate activity in which you materially participated and you were a real estate professional).

However, if you meet any of the five exceptions beginning below, the rental of the property is not treated as a rental activity. See *Reporting Income and Losses From the Activities* on page 3 if you meet any of the exceptions.

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

An activity is not a rental activity if:

1. The average period of customer use is:

a. 7 days or less, or

b. 30 days or less and significant personal services were provided in making the rental property available for customer use.

Figure the average period of customer use for a class of property by dividing the total number of days in all rental periods by the number of rentals during the tax year. If the activity involves renting more than one class of property, multiply the average period of customer use of each class by the ratio of the gross rental income from that class to the activity's total gross rental income. The activity's average period of customer use equals the sum of these class-by-class average periods weighted by gross income. See Regulations section 1.469-1(e)(3)(iii).

Significant personal services include only services performed by individuals. To determine if personal services are significant, all relevant facts and circumstances are taken into consideration, including the frequency of the services, the type and amount of labor required to perform the services, and the value of the services relative to the amount charged for use of the property.

2. Extraordinary personal services were provided in making the rental property available for customer use. This applies only if the services are performed by individuals and the customers' use of the property is incidental to their receipt of the services.

3. Rental of the property 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 is less than 2% of the smaller of the unadjusted basis or the fair market value (FMV) of the property.

Unadjusted basis is the cost of the property without regard to depreciation deductions or any other basis adjustment described in section 1016.

The rental of property is incidental to a trade or business activity if:

- a. You own an interest in the trade or business activity during the tax year,
- b. The rental property was mainly used in the trade or business activity during the tax year or during at least 2 of the 5 preceding tax years, and
- c. The gross rental income from the property is less than 2% of the smaller of the unadjusted basis or the FMV of the property.

Lodging provided for the employer's convenience to an employee or the employee's spouse or dependents is incidental to the activity or activities in which the employee performs services.

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

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

Example. If a partner contributes the use of property to a partnership, none of the partner's distributive share of partnership income is income from a rental activity unless the partnership is engaged in a rental activity.

Also, a partner's gross income from a guaranteed payment under section 707(c) is not income from a rental activity. The determination of whether the property used in the activity is provided in the partner's capacity as an owner of an interest in the partnership is made on the basis of all the facts and circumstances.

Reporting Income and Losses From the Activities

If an activity meets any of the five exceptions listed above, it is not a rental activity. You must then determine:

1. Whether your rental of the property is a trade or business activity (see *Trade or Business Activities* on this page) and, if so,
2. Whether you materially participated in the activity for the tax year (see *Material Participation* on page 4).

- If the activity is a trade or business activity in which you did not materially participate, enter the income and losses from the activity on Worksheet 3.
- If the activity is a trade or business activity in which you did materially participate, report any income or loss from the activity on the forms or schedules normally used.

If the rental activity did not meet any of the five exceptions, it is generally a passive activity. However, special rules apply if you conduct the rental activity through a PTP or if any of the rules described under *Recharacterization of Passive Income* on page 6 apply. See the PTP rules beginning on page 12.

If none of the special rules apply, enter the income and losses from the passive rental activity on Worksheet 1, 2, or 3.

Worksheet 1 is for passive rental real estate activities in which you actively participated. See *Special Allowance for Rental Real Estate Activities* beginning on this page.

Worksheet 2 is for commercial revitalization deductions (CRDs) from rental real estate activities. CRDs from rental real estate activities are not entered on Worksheet 1 or 3. See *Commercial revitalization deduction (CRD)* on page 4.

Worksheet 3 is for passive rental real estate activities in which you did not actively participate, activities of renting personal property, and other passive trade or business activities.

See the instructions for Worksheets 1, 2, and 3 on page 8.

Trade or Business Activities

A trade or business activity is an activity (other than a rental activity or an activity treated as incidental to an activity of holding property for investment) that:

1. Involves the conduct of a trade or business (within the meaning of section 162),
2. Is conducted in anticipation of starting a trade or business, or
3. Involves research or experimental expenditures deductible under section 174 (or that would be if you chose to deduct rather than capitalize them).

Trade or business activities are generally reported on Schedule C (Form 1040), Profit or Loss From Business (Sole Proprietorship), Schedule C-EZ (Form 1040), Net Profit From Business (Sole Proprietorship), or Schedule F (Form 1040), Profit or Loss From Farming, or in Part II or III of Schedule E (Form 1040). See *Publicly Traded Partnerships (PTPs)* beginning on page 12. For trade or business activities that are significant

participation passive activities (defined on page 4), see Pub. 925 for how to report their income or losses.

Special Allowance for Rental Real Estate Activities

Active participation. If you actively participated in a passive rental real estate activity, you may be able to deduct up to \$25,000 of loss from the activity from your nonpassive income. This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities.

The special allowance is not available if you were married, are filing a separate return for the year, and lived with your spouse at any time during the year.

Only an individual, a qualifying estate, or a qualified revocable trust that made an election to treat the trust as part of the decedent's estate may actively participate in a rental real estate activity. Unless future regulations provide an exception, limited partners are not treated as actively participating in a partnership's rental real estate activity.

A qualifying estate is the estate of a decedent for tax years ending less than 2 years after the date of the decedent's death if the decedent would have satisfied the active participation requirements for the rental real estate activity for the tax year the decedent died.

A qualified revocable trust may elect to be treated as part of a decedent's estate for purposes of the special allowance for active participation in rental real estate activities. The election must be made by both the executor (if any) of the decedent's estate and the trustee of the revocable trust. For details, see Regulations section 1.645-1.

You are not considered to actively participate in a rental real estate activity if at any time during the tax year your interest (including your spouse's interest) in the activity was less than 10% (by value) of all interests in the activity.

Active participation is a less stringent requirement than material participation (see *Material Participation* on page 4). You may be treated as actively participating if, for example, you participated in making management decisions or arranged for others to provide services (such as repairs) in a significant and bona fide sense. Management decisions that may count as active participation include:

- Approving new tenants,
- Deciding on rental terms,

- Approving capital or repair expenditures, and
- Other similar decisions.

The maximum special allowance is:

- \$25,000 for single individuals and married individuals filing a joint return for the tax year.
- \$12,500 for married individuals who file separate returns for the tax year and lived apart from their spouses at all times during the tax year.
- \$25,000 for a qualifying estate reduced by the special allowance for which the surviving spouse qualified.

Modified adjusted gross income limitation. If your modified adjusted gross income (see the instructions for line 7 on page 9) is \$100,000 or less (\$50,000 or less if married filing separately), your loss is deductible up to the amount of the maximum special allowance referred to in the preceding paragraph.

If your modified adjusted gross income is more than \$100,000 (\$50,000 if married filing separately) but less than \$150,000 (\$75,000 if married filing separately), your special allowance is limited to 50% of the difference between \$150,000 (\$75,000 if married filing separately) and your modified adjusted gross income.

Generally, if your modified adjusted gross income is \$150,000 or more (\$75,000 or more if married filing separately), there is no special allowance.

If you qualify under the active participation rules, use Worksheet 1 (see page 8).

Commercial revitalization deduction (CRD). The special \$25,000 allowance for the CRD from rental real estate activities is not subject to the active participation rules or modified adjusted gross income limits discussed earlier. The \$25,000 allowance must first be applied to losses from rental real estate activities with active participation, figured without regard to the CRD (see *Part II*). Any remaining portion of the \$25,000 allowance is available for the CRD from rental real estate activities (see *Part III*). See the instructions for *Worksheet 2* on page 8.



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

You can claim a current year CRD for 2010, only if you were a partner or shareholder in a pass-through entity that uses a fiscal year and

- the tax year began in 2009,
- the building was placed in service in 2009, and
- the qualified revitalization expenditures were made in 2009.

Material Participation

For the material participation tests listed below, participation generally includes any work done in connection with an activity if you owned an interest in the activity at the time you did the work. The capacity in which you did the work does not matter. However, work is not participation if:

- It is not work that an owner would customarily do in the same type of activity, and
- One of your main reasons for doing the work was to avoid the disallowance of losses or credits from the activity under the passive activity rules.

Proof of participation. You may prove your participation in an activity by any reasonable means. You do not have to maintain contemporaneous daily time reports, logs, or similar documents if you can establish your participation by other reasonable means. For this purpose, reasonable means include, but are not limited to, identifying services performed over a period of time and the approximate number of hours spent performing the services during that period, based on appointment books, calendars, or narrative summaries.

Tests for individuals. You materially participated for the tax year in an activity if you satisfy at least one of the following tests.

1. You participated in the activity for more than 500 hours.
2. Your participation in the activity for the tax year was substantially all of the participation in the activity of all individuals (including individuals who did not own any interest in the activity) for the year.
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 for the tax year, and you participated in all significant participation activities during the year 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 fourth test).

5. You materially participated in the activity for any 5 (whether or not consecutive) of the 10 immediately preceding tax years.

6. The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years.

An activity is a personal service activity if it involves the performance of

personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or in any other trade or business in which capital is not a material income-producing factor.

7. Based on all the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis during the tax year.

You did not materially participate in the activity under this seventh test, however, if you participated in the activity for 100 hours or less during the tax year.

Your participation in managing the activity does not count in determining whether you materially participated under this test if:

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

Test for a spouse. Participation by your spouse during the tax year in an activity you own may be counted as your participation in the activity even if your spouse did not own an interest in the activity and whether or not you and your spouse file a joint return for the tax year.

Tests for investors. Work done as an investor in an activity is not treated as participation unless you were directly involved in the day-to-day management or operations of the activity. For purposes of this test, work 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.
3. Monitoring the finances or operations of the activity in a nonmanagerial capacity.

Special rules for limited partners. If you were a limited partner in an activity, you generally did not materially participate in the activity. You did materially participate in the activity, however, if you met material participation test 1, 5, or 6 (see *Tests for individuals* on this page) for the tax year.

However, for purposes of the material participation tests, you are not treated as a limited partner if you also were a general partner in the partnership at all times during the partnership's tax year ending with or within your tax year (or, if shorter,

during the portion of the partnership's tax year in which you directly or indirectly owned your limited partner interest).

A limited partner's share of an electing large partnership's taxable income or loss from all trade or business and rental activities is treated as income or loss from the conduct of a single passive trade or business activity.

Special rules for certain retired or disabled farmers and surviving spouses of farmers. Certain retired or disabled farmers and surviving spouses of farmers are treated as materially participating in a farming activity if the real property used in the activity would meet the estate tax rules for special valuation of farm property passed from a qualifying decedent. See Temporary Regulations section 1.469-5T(h)(2).

Estates and trusts. The PAL limitations apply in figuring the distributable net income and taxable income of an estate or trust. The rules for determining material participation for this purpose have not yet been issued.

Grouping of Activities

Generally, one or more trade or business activities or rental activities may be treated as a single activity if the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules.

Whether activities make up an appropriate economic unit depends on all the relevant facts and circumstances. The factors given the greatest weight in determining whether activities make up an appropriate economic unit are:

1. Similarities and differences in types of trades or businesses,
2. The extent of common control,
3. The extent of common ownership,
4. Geographical location, and
5. Interdependencies between or among the activities.

Example. You have a significant ownership interest in a bakery and a movie theater in Baltimore and in a bakery and a movie theater in Philadelphia. Depending on all the relevant facts and circumstances, there may be more than one reasonable method for grouping your activities. For instance, the following groupings may or may not be permissible:

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

Once you choose a grouping under these rules, you must continue using that grouping in later tax years unless a material change in the facts and circumstances makes it clearly inappropriate.

The IRS may regroup your activities if your grouping fails to reflect one or more appropriate economic units and one of the primary purposes of your grouping is to avoid the passive activity limitations.

Limitation on grouping certain activities. The following activities may not be grouped together.

1. A rental activity with a trade or business activity unless the activities being grouped together make up an appropriate economic unit and:
 - a. The rental activity is insubstantial relative to the trade or business activity or vice versa, or
 - b. Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity. If so, the portion of the rental activity involving the rental of property used in the trade or business activity may be grouped with the trade or business activity.

2. An activity involving the rental of real property with an activity involving the rental of personal property (except personal property provided in connection with the real property or vice versa).

3. Any activity with another activity in a different type of business and in which you hold an interest as a limited partner or as a limited entrepreneur (as defined in section 464(e)(2)) if that other activity engages in holding, producing, or distributing motion picture films or videotapes; farming; leasing section 1245 property; or exploring for or exploiting oil and gas resources or geothermal deposits.

Activities conducted through partnerships, S corporations, and C corporations subject to section 469. Once a partnership or corporation determines its activities under these rules, a partner or shareholder may use these rules to group those activities with:

- Each other,
- Activities conducted directly by the partner or shareholder, or
- Activities conducted through other partnerships and corporations.

A partner or shareholder may not treat as separate activities those activities grouped together by the partnership or corporation.

Disclosure Requirement

For tax years beginning after January 24, 2010, the following disclosure requirements for groupings apply. You are required to report certain changes to your groupings that occur during the

tax year to the IRS. If you fail to report these changes, each trade or business activity or rental activity will be treated as a separate activity. You will be considered to have made a timely disclosure if you filed all affected income tax returns consistent with the claimed grouping and make the required disclosure on the income tax return for the year in which you first discovered the failure to disclose. If the IRS discovered the failure to disclose, you must have reasonable cause for not making the required disclosure. For more information on disclosure requirements, see Revenue Procedure 2010-13 available at www.irs.gov/irb/2010-4_IRB/ar15.html.

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

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

Regrouping. You must file a written statement with your original income tax return for the tax year in which you regroup the activities. The statement must provide the names, addresses, and EINs, if applicable, for the activities that are being regrouped. If two or more activities are being regrouped into a single activity, the statement must contain a declaration that the regrouped activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules. In addition, the statement must contain an explanation of the material change in the facts and circumstances that made the original grouping clearly inappropriate.

Passive Activity Income and Deductions

Take into account only passive activity income and passive activity deductions to figure your net income or net loss

from all passive activities or any passive activity.

If your passive activity is reported on Schedule C, C-EZ, E, or F, and the activity has no prior year unallowed losses or any gain or loss from the disposition of assets or an interest in the activity, take into account only the passive activity income and passive activity deductions from the activity to figure the amount to enter on Form 8582 and the worksheets.

If you own an interest in a passive activity through a partnership or an S corporation, the partnership or S corporation will generally provide you with the net income or net loss from the passive activity. If, however, the partnership or S corporation must state an item of gross income or deduction separately to you, and the gross income or deduction is passive activity gross income or a passive activity deduction (respectively), include that amount in the net income or net loss entered on Form 8582 and the worksheets.



The partnership or S corporation does not have a record of any prior year unallowed losses from the passive activities of the partnership or S corporation. If you had prior year unallowed losses from these activities, they can be found in column (c) of your 2009 Worksheet 5.

Self-Charged Interest

Certain self-charged interest income or deductions may be treated as passive activity gross income or passive activity deductions if the loan proceeds are used in a passive activity. Generally, self-charged interest income and deductions result from loans between you and a partnership or S corporation in which you had a direct or indirect ownership interest. This includes both loans you made to the partnership or S corporation and loans the partnership or S corporation made to you. It also includes loans from one partnership or S corporation to another partnership or S corporation if each owner in the borrowing entity has the same proportional ownership interest in the lending entity. The self-charged interest rules do not apply to your interest in a partnership or S corporation if the entity made an election under Regulations section 1.469-7(g) to avoid the application of these rules. For more details on the self-charged interest rules, see Regulations section 1.469-7.

Passive Activity Income

To figure your overall gain or loss from all passive activities or any passive activity, take into account only passive activity income. Do not enter income that is not passive activity income on Form 8582 or the worksheets.

Passive activity income includes all income from passive activities, including (with certain exceptions described in Temporary Regulations section 1.469-2T(c)(2) and Regulations section 1.469-2(c)(2)) gain from the disposition of an interest in a passive activity or of property used in a passive activity at the time of the disposition.

Passive activity income does not include the following.

- Income from an activity that is not a passive activity.
- Portfolio income, including interest (other than self-charged interest treated as passive activity income), dividends, annuities, and royalties not derived in the ordinary course of a trade or business, and gain or loss from the disposition of property that produces portfolio income or is held for investment (see section 163(d)(5)). See Temporary Regulations section 1.469-2T(c)(3).
- Alaska Permanent Fund dividends.
- Personal service income, including salaries, wages, commissions, self-employment income from trade or business activities in which you materially participated for the tax year, deferred compensation, taxable social security and other retirement benefits, and payments from partnerships to partners for personal services. See Temporary Regulations section 1.469-2T(c)(4).
- Income from positive section 481 adjustments allocated to activities other than passive activities. See Temporary Regulations section 1.469-2T(c)(5).
- Income or gain from investments of working capital.
- Income from an oil or gas property if you treated any loss from a working interest in the property for any tax year beginning after 1986 as a nonpassive loss under the rule excluding working interests in oil and gas wells from passive activities (see item 3 under *Activities That Are Not Passive Activities* on page 2). See Regulations section 1.469-2(c)(6).
- Any income from intangible property if your personal efforts significantly contributed to the creation of the property.
- Any income treated as not from a passive activity under Temporary Regulations section 1.469-2T(f) and Regulations section 1.469-2(f). See *Recharacterization of Passive Income* on this page.
- Overall gain from any interest in a PTP (see item 2 under *Special Instructions for PTPs* beginning on page 12).
- State, local, and foreign income tax refunds.
- Income from a covenant not to compete.
- Any reimbursement of a casualty or theft loss included in income as

recovery of all or part of a prior year loss deduction if the deduction for the loss was not treated as a passive activity deduction.

- Cancellation of debt income to the extent that at the time the debt was discharged, the debt was not properly allocable under Temporary Regulations section 1.163-8T to passive activities.

Recharacterization of Passive Income

Certain income from passive activities must be recharacterized and excluded from passive activity income. The amount of income recharacterized equals the net income from the sources given below. If during the tax year you received net income from any of these sources (either directly or through a partnership or an S corporation), see Pub. 925 to find out how to report net income or loss from these sources. For more information, see Temporary Regulations section 1.469-2T(f) and Regulations section 1.469-2(f).

Income from the following sources may be subject to the net income recharacterization rules.

- Significant participation passive activities defined on page 4.
- Rental of property if less than 30% of the unadjusted basis of the property is subject to depreciation.
- Passive equity-financed lending activities.
- Rental of property incidental to a development activity.
- Rental of property to a nonpassive activity.
- Acquisition of an interest in a pass-through entity that licenses intangible property.

Passive Activity Deductions

To figure your overall gain or overall loss from all passive activities or any passive activity, take into account only passive activity deductions.

Passive activity deductions include all deductions from activities that are passive activities for the current tax year and all deductions from passive activities that were disallowed under the PAL rules in prior tax years and carried forward to the current tax year. See Regulations section 1.469-1(f)(4).

Passive activity deductions include losses from a disposition of property used in a passive activity at the time of the disposition and losses from a disposition of less than your entire interest in a passive activity. See *Dispositions* on page 7 for the treatment of losses upon disposition of your entire interest in an activity.

Passive activity deductions do not include the following.

- Deductions for expenses (other than interest expense) that are clearly and directly allocable to portfolio income.

- Qualified home mortgage interest, capitalized interest expenses, and other interest expenses (except self-charged interest treated as a passive activity deduction (discussed on page 6) and interest expenses properly allocable to passive activities).
- Losses from dispositions of property that produce portfolio income or property held for investment.
- State, local, and foreign income taxes.
- Miscellaneous itemized deductions that may be disallowed under section 67.
- Charitable contribution deductions.
- Net operating loss deductions, percentage depletion carryovers under section 613A(d), and capital loss carryovers.
- Deductions and losses that would have been allowed for tax years beginning before 1987, but for basis or at-risk limitations.
- Net negative section 481 adjustments allocated to activities other than passive activities. See Temporary Regulations section 1.469-2T(d)(7).
- Deductions for losses from fire, storm, shipwreck, or other casualty or from theft if losses similar in cause and severity do not recur regularly in the activity.
- The deduction allowed for one-half of self-employment taxes.

Former Passive Activities

A former passive activity is any activity that was a passive activity in a prior tax year but is not a passive activity in the current tax year. A prior year unallowed loss from a former passive activity is allowed to the extent of current year income from the activity.

If current year net income from the activity is less than the prior year unallowed loss, enter the prior year unallowed loss and any current year net income from the activity on Form 8582 and the applicable worksheets.

If current year net income from the activity is more than or equal to the prior year unallowed loss from the activity, report the income and loss on the forms and schedules normally used; do not enter the amounts on Form 8582.

If the activity has a net loss for the current year, enter the prior year unallowed loss (but not the current year loss) on Form 8582 and the applicable worksheets.

To report a disposition of a former passive activity, follow the rules under *Dispositions*, next.

Dispositions

Disposition of an Entire Interest

If you disposed of your entire interest in a passive activity or a former passive activity to an unrelated person in a fully taxable transaction during the tax year, your losses allocable to the activity for the year are not limited by the PAL rules.

A fully taxable transaction is a transaction in which you recognize all realized gain or loss.

If you are using the installment method to report this kind of disposition, figure the loss for the current year that is not limited by the PAL rules by multiplying your overall loss (which does not include losses allowed in prior years) by the following fraction:

$$\frac{\text{Gain recognized in the current year}}{\text{Unrecognized gain as of the beginning of the current year}}$$

A partner in a PTP is not treated as having disposed of an entire interest in an activity of a PTP until there is an entire disposition of the partner's interest in the PTP.

Reporting an Entire Disposition on Schedule D or Form 4797

If you completely dispose of your entire interest in a passive activity or a former passive activity, you may have to report net income or loss and prior year unallowed losses from the activity. All the net income and losses are reported on the forms and schedules normally used.

Combine all income and losses (including any prior year unallowed losses) from the activity for the tax year to see if you have an overall gain or loss.

If you have an overall gain and you have other passive activities to report on Form 8582, include the income, losses, and prior year unallowed losses on Worksheet 1, 2, or 3.

If you have an overall gain and this is your only passive activity or a former passive activity, report all income and losses (including any prior year unallowed losses) on the forms and schedules normally used and do not use Form 8582.

If you have an overall loss when you combine the income and losses, do not use the worksheets or Form 8582 for the activity. All losses (including prior year unallowed losses) are allowed in full. Report the income and losses on the forms and schedules normally used.

An overall loss from an entire disposition of a passive activity is a nonpassive loss if you have an aggregate loss from all other passive activities. When figuring your modified adjusted gross income for line 7 of Form 8582, be sure to take into account the overall loss from the disposition of the activity.

Example 1. Activity with overall gain. You sell your entire interest in a rental real estate activity in which you actively participated for a gain of \$15,525. \$7,300 of the gain is section 1231 gain reported on Form 4797, Part I, and \$8,225 is ordinary recapture income reported on Form 4797, Part II. On line 23 of Schedule E (Form 1040), you report a total loss of \$15,450, which includes a current year \$2,800 net loss and a \$12,650 prior year unallowed loss. You have an overall gain from the disposition (\$15,525 – \$15,450 = \$75).

Because you had other passive activities reportable on Form 8582, you make the following entries on Worksheet 1. You enter the \$15,525 gain on the disposition in column (a), the current year loss of \$2,800 in column (b), and the prior year unallowed loss of \$12,650 in column (c).

Example 2. Activity with overall loss. You sell your entire interest in an oil and gas limited partnership that was your only passive activity for a gain of \$2,000. You have a current year Schedule E loss of \$3,330 and a Schedule E prior year unallowed loss of \$1,115.

Because you have an overall loss of \$2,445 after combining the gain and losses, none of the amounts are entered on Worksheet 3 or on Form 8582.

You enter the net loss plus the prior year unallowed loss (\$3,330 + \$1,115 = \$4,445) on Schedule E, Part II, column (h), and the \$2,000 gain on the sale on Schedule D, in either Part I or Part II, depending on how long you held the partnership interest.

Disposition of Less Than an Entire Interest

Gains and losses from the disposition of less than an entire interest in an activity are treated as part of the net income or net loss from the activity for the current year.



A disposition of less than substantially all of an entire interest does not trigger the allowance of prior year unallowed losses.

Disposition of substantially all of an activity. You may treat the disposition of substantially all of an activity as a

separate activity if you can prove with reasonable certainty:

1. The prior year unallowed losses, if any, allocable to the part of the activity disposed of, and
2. The net income or loss for the year of disposition allocable to the part of the activity disposed of.


Specific Instructions

Part I—2010 Passive Activity Loss

Use Part I to combine the net income and net loss from all passive activities to determine if you have a passive activity loss (PAL) for 2010. Use Worksheets 1, 2, and 3 to determine the entries for lines 1–3 of Part I, as follows.

- Worksheet 1 is used for rental real estate activities with active participation.
- Worksheet 2 is used for commercial revitalization deductions (CRDs) from rental real estate activities (with or without active participation).
- Worksheet 3 is used for all other passive activities.


See Pub. 925 for examples showing how to complete the worksheets.

 *If you need additional lines for any of the worksheets, you can either attach copies of page 2 or 3, whichever is applicable, or your own schedule that is in the same format as the worksheet.*

Worksheet 1

Individuals and qualifying estates who actively participated in rental real estate activities must include the income or loss from those activities in Worksheet 1 to figure the amounts to enter on lines 1a through 1c of Form 8582. Do not include any commercial revitalization deductions (CRDs) from these activities in the net income or loss reported in Worksheet 1.

Do not enter a prior year unallowed loss in column (c) of Worksheet 1 unless you actively participated in the activity in both the year the loss arose and the current tax year. If you did not actively participate in both years, enter the prior year unallowed loss in column (c) of Worksheet 3.

 *Married individuals who file separate returns and lived with their spouses at any time during the tax year do not qualify under the active participation rule and must use Worksheet 3 instead of Worksheet 1.*

Column (a). Enter the current year net income from each activity. Enter the total of column (a) on line 1a of Form 8582.

Example. A Schedule E rental activity has current year profit of \$5,000 and a Form 4797 gain of \$2,000. You enter \$7,000 in column (a).

Column (b). Enter the current year net loss for each activity. Do not enter any prior year unallowed losses in this column. Enter the total of column (b) on line 1b of Form 8582.

If an activity has net income on one form or schedule and a net loss on another form or schedule, report the net amounts separately in columns (a) and (b) of Worksheet 1.


Example. A Schedule E rental activity has current year income of \$1,000 on line 22 of Schedule E and a current year Form 4797 loss of \$4,500. You enter \$1,000 in column (a) and (\$4,500) in column (b).

Column (c). Enter the prior year unallowed losses for each activity. You find these amounts on Worksheet 5, column (c), of your 2009 Form 8582. Enter the total of column (c) from your 2010 Worksheet 1 on line 1c of Form 8582.

Columns (d) and (e). Combine income and losses in columns (a) through (c) for each activity, and either enter the overall gain for the activity in column (d) or enter the overall loss for the activity in column (e). Do not enter amounts from columns (d) and (e) on Form 8582. These amounts will be used when Form 8582 is completed to figure the loss allowed for the current year.

Worksheet 2

Use Worksheet 2 to figure the amount to enter on lines 2a and 2b for commercial revitalization deductions (CRD) from rental real estate activities (see *Commercial revitalization deduction (CRD)* on page 4).

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

Do not include the following amounts on Worksheet 2.

- Income or other deductions from the same activity. Instead, report any net income or net loss from the activity, except for the CRD, in Worksheet 1 if you actively participated in the activity or in Worksheet 3 if you did not actively participate.
- CRDs from passive activities other than rental real estate activities. Instead, report these deductions as part of the net income or loss from the passive activity in Worksheet 3.

Column (a). Enter the current year CRD from each rental real estate activity. You can claim a current year CRD for 2010, only if you were a partner or shareholder in a pass-through entity that uses a fiscal year and

- the tax year began in 2009,
 - the building was placed in service in 2009, and
 - the qualified revitalization expenditures were made in 2009.
- Enter the total of column (a) on line 2a of Form 8582.

Column (b). Enter the prior year unallowed CRDs for each rental real estate activity. Enter the total of column (b) on line 2b of Form 8582.

Column (c). Combine the amounts in columns (a) and (b) for each activity and enter the overall loss for the activity in column (c). These amounts will be used when Form 8582 is completed to figure the loss allowed for the current year.

Worksheet 3

Use Worksheet 3 to figure the amounts to enter on lines 3a through 3c for:

- Passive trade or business activities,
- Passive rental real estate activities that do not qualify for the special allowance (but do not include CRDs reported in Worksheet 2), and
- Rental activities other than rental real estate activities.

Column (a). Enter the current year net income for each activity. Enter the total of column (a) on line 3a of Form 8582. (See the example under *Column (a)* for Worksheet 1, on this page.)

Column (b). Enter the current year net loss for each activity. Enter the total of column (b) on line 3b of Form 8582. (See the example under *Column (b)* for Worksheet 1, on this page.)

Column (c). Enter the unallowed losses for the prior years for each activity. You find these amounts on Worksheet 5, column (c), of your 2009 Form 8582. Enter the total of column (c) from your 2010 Worksheet 3 on line 3c of Form 8582.

Columns (d) and (e). Combine income and losses in columns (a) through (c) for each activity, and either enter the overall gain for the activity in column (d) or enter the overall loss for the activity in column (e). Do not enter amounts from columns (d) and (e) on Form 8582. These amounts will be used when Form 8582 is completed to figure the loss allowed for the current year.

Part II—Special Allowance for Rental Real Estate Activities With Active Participation

Use Part II to figure the maximum amount of rental loss allowed if you have a net loss from a rental real estate activity with active participation.

Enter all numbers in Part II as positive amounts (that is, greater than zero).

Example. Line 5 has a loss of \$42,000 (reported as a positive amount) and line 9 is \$25,000. You enter \$25,000 on line 10 (the smaller of line 5 or line 9, both treated as positive amounts).



Married persons filing separate returns who lived with their spouses at any time during the year are not eligible for the special allowance. They must enter -0- on line 10 and go to line 15.

Line 5. Enter on line 5 the smaller of the loss on line 1d or the loss on line 4.

Example. Line 1d has a loss of \$3,000, line 2c is zero, and line 3d has a gain of \$100. The combined loss on line 4 is \$2,900. You enter \$2,900 as a positive number on line 5 (the smaller of the loss on line 1d or the loss on line 4).

Line 6. Married persons filing separate returns who lived apart from their spouses at all times during the year must enter \$75,000 on line 6 instead of \$150,000.

Line 7. To figure modified adjusted gross income, combine all the amounts used to figure adjusted gross income except do not take into account:

- Passive income or loss included on Form 8582,
- Any rental real estate loss allowed to real estate professionals (defined under *Activities That Are Not Passive Activities* on page 2),
- Any overall loss from a PTP,
- The taxable amount of social security and tier 1 railroad retirement benefits,
- Deductible contributions to traditional individual retirement accounts (IRAs) and section 501(c)(18) pension plans,
- The domestic production activities deduction,
- The deduction allowed for one-half of self-employment taxes,
- The exclusion from income of interest from series EE and I U.S. savings bonds used to pay higher education expenses,
- The exclusion of amounts received under an employer's adoption assistance program,
- The student loan interest deduction, or
- The tuition and fees deduction.

Include in modified adjusted gross income any portfolio income and expenses that are clearly and directly allocable to portfolio income. Also include any income that is treated as nonpassive income, such as overall gain from a PTP and net income from an activity or item of property subject to the recharacterization of passive income rules.

When figuring modified adjusted gross income, include any overall loss from the entire disposition of a passive activity (considered a nonpassive loss).

Example. Your adjusted gross income on line 37 of Form 1040 is \$92,000, and you have taxable social security benefits of \$5,500 on line 20b. Your modified adjusted gross income is \$86,500 (\$92,000 – \$5,500).

Line 9. Do not enter more than \$12,500 on line 9 if you are married filing a separate return and you and your spouse lived apart at all times during the year.

Part III—Special Allowance for Commercial Revitalization Deductions From Rental Real Estate Activities

Use Part III to figure the maximum commercial revitalization deduction allowed from a rental real estate activity.

Enter all numbers in Part III as positive amounts (that is, greater than zero.)



Married persons filing separate returns who lived with their spouses at any time during the year are not eligible for the special allowance. They must enter -0- on line 14 and go to line 15.

Line 11. Enter \$12,500 (reduced by the amount, if any, on line 10) on line 11 if you are married filing a separate return and you and your spouse lived apart at all times during the year.

Part IV—Total Losses Allowed

Use Part IV to figure the amount of the PAL (as determined in Part I) allowed for 2010 from all passive activities.

Line 16. Use the worksheets on Form 8582 and the following instructions for those worksheets to figure the unallowed loss to be carried forward and the allowed loss to report on your forms and schedules for 2010.

Worksheets 1, 2, and 3

Worksheets 1 and 3, columns (d) and (e), show whether an activity had an overall gain or loss. Worksheet 2, column (c), shows the CRDs from rental real estate activities. If you have activities that show overall gain in column (d) of Worksheet 1 or 3, report all the income and losses listed in columns (a), (b), and (c) for those activities on the proper forms and schedules.

If you have activities that show an overall loss in column (e) of Worksheet 1 or 3 or column (c) of Worksheet 2, you must allocate your allowed loss on

line 16 of Form 8582 to those activities by completing Worksheets 4, 5, and 6 or 7.

Complete Worksheet 4 only if you entered an amount (other than zero) on line 10 or 14 of Form 8582. Otherwise, skip Worksheet 4 and complete Worksheet 5 for all activities in Worksheets 1 or 3 that have overall losses in column (e) and all activities in Worksheet 2.

Worksheet 4

Use Worksheet 4 to allocate the special allowance on line 10 or line 14 of Form 8582 among your rental real estate activities.

In the first column of Worksheet 4, enter the name of each activity. In the second column, enter the form or schedule and line number on which the loss will be reported.

Example. You receive a Schedule K-1 from partnership P that reports losses from two rental real estate activities, Activity X and Activity Y. The losses from partnership P are reported on line 28A of Schedule E. In the first two columns of Worksheet 4, enter:

Name of Activity	Form or Schedule
Activity X	Sch E, line 28A
Activity Y	Sch E, line 28A

If the loss from an activity is reported in more than one place, identify both locations in the second column (for example, Sch E, line 28A/Form 4797, line 2). If you need additional space, show this information on an attached statement.

Enter all activities with overall losses from Worksheets 1 and 2 as follows.

- If you entered an amount on line 10, list on Worksheet 4 all activities with an overall loss in column (e) of Worksheet 1.
- If you entered an amount on line 14, list on Worksheet 4 all activities with an overall loss in column (c) of Worksheet 2.
- If you entered amounts on both lines 10 and 14 of Form 8582, you must complete two separate Worksheets 4. For the second worksheet, you either may attach an extra copy of page 2 of Form 8582 or your own schedule in the same format as Worksheet 4. On the first Worksheet 4, list all activities with an overall loss in column (e) of Worksheet 1. On the second Worksheet 4, list all activities with an overall loss in column (c) of Worksheet 2.

Column (a). Enter the overall loss from column (e) of Worksheet 1 or column (c) of Worksheet 2 for each activity.

Column (b). Divide each of the individual losses shown in column (a) by the total of all the losses in column (a) and enter this ratio for each activity in column (b). The total of all the ratios in column (b) must equal 1.00.

Column (c). Multiply each ratio in column (b) by the amount on line 10 or line 14 of Form 8582, and enter the results in column (c). The total of column (c) must be the same as line 10 or line 14 of Form 8582.

Column (c) total is the same as column (a) total. If the total losses in column (c) are the same as those in column (a), the losses in Worksheets 1 and 2 are allowed in full and are not carried over to Worksheet 5. Report all amounts in columns (a), (b), and (c) of Worksheet 1 and columns (a) and (b) of Worksheet 2 on the proper forms and schedules.

Column (c) total is less than column (a) total. If the total losses in column (c) are less than the total losses in column (a), complete column (d).

Column (d). Subtract column (c) from column (a) and enter the results in column (d). Also enter the amounts from column (d) of Worksheet 4 in column (a) of Worksheet 5.

Worksheet 5

Complete Worksheet 5 if any activities have an overall loss in column (e) of Worksheet 3 or losses in column (d) of Worksheet 4 (in column (e) of Worksheet 1 or column (c) of Worksheet 2 if you did not have to complete Worksheet 4).

On Worksheet 5, enter the name of each activity and the form or schedule and line number on which the loss will be reported. See the example for Worksheet 4. Identify any deduction from Worksheet 2 on a separate line (even if the amount is from an activity also shown on Worksheet 1 or 3) and add "CRD" after the name of the activity.

Column (a). Enter the amounts, if any, from column (d) of Worksheet 4 (from column (e) of Worksheet 1 or column (c) of Worksheet 2 if you did not have to complete Worksheet 4). Also enter the losses, if any, from column (e) of Worksheet 3.

Column (b). Divide each of the individual losses shown in column (a) by the total of all the losses in column (a) and enter this ratio for each activity in column (b). The total of all the ratios must equal 1.00.

Column (c). Complete the following computation.

-
- A. Enter as a positive amount
line 4 of Form 8582 _____
- B. Add lines 10 and 14 of
Form 8582 _____
- C. Subtract line B from line A . . . _____
-

Multiply each ratio in column (b) by the amount on line C above, and enter the result in column (c).

Worksheets 6 and 7

These worksheets allocate your unallowed and allowed losses for each activity.

If you have losses from any activity that are reported on two or more different forms or schedules, use Worksheet 7 instead of Worksheet 6 for that activity.

Also use Worksheet 7 instead of Worksheet 6 for any activity with two or more transactions that are reported on the same form or schedule but must be separately identified for tax purposes. Transactions that must be separately identified include capital losses that are 28% rate losses and those that are not.

Note. 28% rate gain or loss includes all collectibles gains and deductible long-term losses and section 1202 gain on the sale of qualified small business stock. See the instructions for Schedule D (Form 1040) for details.

Worksheet 6

Use Worksheet 6 for any activity listed in Worksheet 5 if all the loss from that activity is reported on one form or schedule and no transactions need to be identified separately (as discussed on this page).

Example. Use Worksheet 6 if all the loss from an activity is reported on Schedule E, even though part of the loss is a current year Schedule E loss and part of it is from a Schedule E prior year unallowed loss.

On Worksheet 6, enter the name of each activity and the form or schedule and line number on which the loss is reported. See the example for Worksheet 4. Identify each CRD from Worksheet 5 on a separate line and add "CRD" after the name of the activity.

Column (a). For each activity entered in Worksheet 6, enter the net loss plus the prior year unallowed loss for the activity. Figure this amount by adding the losses in columns (b) and (c) of Worksheets 1 and 3 or enter the loss from column (c) of Worksheet 2.

Column (b). For each activity entered in Worksheet 6, enter the amount from column (c) of Worksheet 5 for the activity. These are your unallowed losses for 2010. Keep a record of these

amounts so the losses can be used to figure your PAL next year.

Column (c). Subtract column (b) from column (a). These are your allowed losses for 2010. Report the amounts in this column on the forms and schedules normally used.

See the forms and schedules listed under *How To Report Allowed Losses* beginning on page 11. Also, see Pub. 925 for an extensive example of how to report passive income and losses on the forms and schedules.

Worksheet 7

Use Worksheet 7 for any activity listed in Worksheet 5 that has losses that are reported on two or more different forms and schedules or on different parts of the same form or schedule (for example, 28% rate and non-28%-rate capital losses reported on Schedule D). Worksheet 7 allocates the allowed and unallowed loss for the activity and allocates the allowed loss to the different forms or schedules (or different parts of the same form or schedule) used to report the losses.

Only losses that would cause a difference in tax liability if they were reported on a different form or schedule or on different parts of the same form or schedule are kept separate. Those forms, schedules, and parts are:

- Schedules C, E, and F.
- Schedule D (Parts I and II (28% rate losses and non-28%-rate losses)).

Note. You must make a separate entry in Schedule D, Part I or Part II, for each transaction reported. See the Instructions for Schedule D (Form 1040).

- Forms 4684 (Section B), 4797 (Parts I and II), and 4835.

Use a separate copy of Worksheet 7 for each activity for which you have losses reported on two or more different forms or schedules or different parts of the same form or schedule.

On Worksheet 7, enter the form or schedule and line number on the dotted line above each line 1a (for example, Schedule D, line 12, to report a 28% rate loss from a partnership).

Line 1a, column (a). Enter the net loss plus any prior year unallowed loss from the activity that is reported on the same form or, in the case of Schedule D and Form 4797, the same part.

If you have a Schedule D 28% rate loss and a Schedule D non-28%-rate loss, see *Example of Schedule D (Form 1040) transactions* on page 11 before completing Worksheet 7.

Line 1b, column (a). Enter any net income from the activity that is reported on the same form or schedule (or on the same part of the same form or schedule) as the loss on line 1a, column (a).

Example. You enter a prior year unallowed loss from Form 4797, Part I, on line 1a. If the activity has a current year Form 4797, Part I, gain, enter the gain on line 1b, column (a). If the activity does not have a Form 4797, Part I, gain, enter -0- on line 1b, column (a).

Line 1c, column (b). Subtract line 1b, column (a), from line 1a, column (a), and enter the result in column (b). If line 1b, column (a), is more than line 1a, column (a), enter -0- in column (b).

Column (c). Divide each of the losses entered in column (b) by the total of column (b) and enter the ratio in column (c). The total of this column must be 1.00.

Column (d). Multiply the unallowed loss for this activity, found in Worksheet 5, column (c), by each ratio in column (c) of Worksheet 7. If -0- is entered in column (b) of Worksheet 7, also enter -0- for that form or schedule in column (d).

The amount in column (d) is the unallowed loss for 2010. Keep a record of this worksheet so you can use the losses to figure your PAL next year.

Column (e). Subtract the amount in column (d) from the loss entered on line 1a, column (a). This is the allowed loss for 2010 to enter on the forms or schedules. The forms and schedules you use must show the losses from this column and the income, if any, for that activity from column (a) of Worksheet 1 or Worksheet 3.

Example of Schedule D (Form 1040) transactions. The taxpayer had the following Schedule D (Form 1040) transactions from passive activities in 2010.

Activity I

A passive activity prior year unallowed long-term capital loss (a 28% rate loss) of \$1,000 and a current year long-term capital loss (a non-28%-rate loss) of \$3,000.

Activity II

A current year collectibles loss (a 28% rate loss) of \$230 and net income of \$1,100 from Schedule E (Form 1040).

Worksheet 3

Activity I has an overall loss of \$4,000 (current year long-term capital loss of \$3,000 and a prior year unallowed long-term capital loss of \$1,000). Activity II has an overall gain of \$870 (current year net income of \$1,100 less a current year long-term capital loss of \$230). Line 16 of Form 8582 shows an allowed loss of \$1,100.

Since Activity II has an overall gain, the amounts shown in columns (a) and (b) of Worksheet 3 for that activity are reported on the proper forms and

schedules and are not shown on any other worksheet.

Worksheet 5

Activity I has an unallowed loss of \$3,130 (line 4 of Form 8582 (\$3,130) less the sum of lines 10 and 14 of Form 8582 (-0-) x 100%).

Worksheet 7

This worksheet is used to figure the portion of the unallowed loss attributable to the 28% rate loss and the portion attributable to the non-28%-rate loss.

The loss attributable to the 28% rate loss (\$1,000) and the loss attributable to the non-28%-rate loss (\$3,000) are separate entries in Worksheet 7. The ratio of each loss to the total of the two losses is figured as follows. $\$1,000/\$4,000 = .25$. $\$3,000/\$4,000 = .75$. Each of these ratios is multiplied by the unallowed loss for Activity I, shown in column (c) of Worksheet 5 (\$3,130).

Unallowed losses for Activity I:

- 28% rate loss: $.25 \times \$3,130 = \782.50 .
- Non-28%-rate loss: $.75 \times \$3,130 = \$2,347.50$.

Allowed losses for Activity I:

- 28% rate loss: $\$1,000 - \$782.50 = \$217.50$.
- Non-28%-rate loss: $\$3,000 - \$2,347.50 = \$652.50$.

The total loss allowed for Activity I (\$870) is entered in Part II of Schedule D (Form 1040). The 28% rate loss (\$217.50) is entered on the 28% Rate Gain Worksheet (see Schedule D instructions for line 18). Keep a record of the unallowed 28% rate and non-28%-rate losses to figure the PAL for these transactions next year.

See the forms and schedules listed under *How To Report Allowed Losses* below. Also, see Pub. 925 for an extensive example of how to report passive income and losses on the forms and schedules.

How To Report Allowed Losses

Line 4 is income. If line 4 of Form 8582 shows net income or zero, all the losses in columns (b) and (c) of Worksheets 1 and 3 and all the deductions in columns (a) and (b) of Worksheet 2 are allowed in full. Report the income and losses in columns (a), (b), and (c) of Worksheets 1 and 3 and deductions in columns (a) and (b) of Worksheet 2 on the forms and schedules normally used.

Line 16 is the same as the total of lines 1b, 1c, 2a, 2b, 3b, and 3c. In this case, all the losses in columns (b) and (c) of Worksheets 1 and 3 and all the deductions in columns (a) and (b) of Worksheet 2 are allowed in full. Report the income and losses in columns (a),

(b), and (c) of Worksheets 1 and 3 and deductions in columns (a) and (b) of Worksheet 2 on the forms and schedules normally used.

Columns (a) and (c) of Worksheet 4 are the same amount. In this case, all the losses in columns (b) and (c) of Worksheet 1 and all the deductions in columns (a) and (b) of Worksheet 2 are allowed in full. Report the income and losses in columns (a), (b), and (c) of Worksheet 1 and the deductions in columns (a) and (b) of Worksheet 2 on the forms and schedules normally used.

Losses allowed in column (c) of Worksheet 6. The amounts in column (c) of Worksheet 6 are the losses or deductions allowed for 2010 for the activities listed in that worksheet. Report the loss allowed from column (c) of Worksheet 6 and the income, if any, for that activity from column (a) of Worksheet 1 or 3, on the form or schedule normally used.

Losses allowed in column (e) of Worksheet 7. The amounts in column (e) of Worksheet 7 are the losses or deductions allowed for 2010 for the activity listed on that worksheet. Report the losses allowed from column (e) of Worksheet 7 and the income, if any, for that activity from column (a) of Worksheet 1 or 3, on the forms or schedules normally used.

Schedules C and F, and Form 4835.

Enter on the net profit or loss line of your schedule or form the allowed passive loss from the worksheet. To the left of the entry space, enter "PAL."

If the net profit or loss line on your form or schedule shows net profit for the year, reduce the net profit by the allowed loss from Worksheet 6 or 7, and enter the result on the net profit or loss line.

Example. Schedule C shows net profit for the year of \$5,000 from a passive activity. The activity also has a Form 4797 gain of \$2,500 and a prior year unallowed Schedule C loss of \$6,000. The loss allowed for 2010 is \$6,000. You enter a net loss of \$1,000 on line 31 of Schedule C (the \$5,000 net profit for the year less the \$6,000 loss allowed for the year). To the left of the entry space, you enter "PAL."

See *Schedule D and Form 4797* instructions on page 12 if you also had passive gains and losses from the sale of assets or of an interest in a passive activity.

Schedule E, Part I. Enter the allowed loss from the worksheet on line 23 of Schedule E. An activity that has net profit for the year and prior year unallowed losses will have net profit on line 22 and the allowed loss on line 23. The allowed loss on line 23 will include the loss allowed to the extent of the net profit. Line 24 of Schedule E will show total profit and line 25 will show total

losses allowed (both passive and nonpassive). Line 26 will show the total net profit or loss.

Schedule E, Parts II and III. Any net income shown on your Schedule K-1 that is passive income must be entered as passive income in the appropriate column of Schedule E, Part II or III. Enter the passive loss allowed from Worksheet 6 or 7 in the appropriate column for passive losses. The passive losses allowed include the loss allowed to the extent of any net income from the activity. Passive net income or loss reportable on Schedule E, Part II, includes any self-charged interest income and deductions treated as passive activity income and deductions. See *Self-Charged Interest* on page 6.

See *Schedule D and Form 4797* instructions on this page if you also had passive gains or losses from the sale of assets or of an interest in a passive activity.

Form 4684, Section B. Any passive activity gain from Form 4684 is unchanged. It was used on Form 8582 to determine allowable PALs. If you do not have passive losses on Form 4684, complete Form 4684 and follow the instructions for that form for where to report the gain.

If you have passive losses on Form 4684, cross through the amount you first entered on line 34, 35, 41a, 41b, or 42 of that form, and enter the allowed loss from the worksheet. To the left of the entry space, enter "PAL."

Schedule D and Form 4797. If you sold assets from a passive activity or you sold an interest in your passive activity, all gains from the activity must be entered on the appropriate line of Schedule D or Form 4797. Identify the gain as "FPA." Enter any allowed losses for Schedule D or Form 4797 on the appropriate line, and to the left of the entry space, enter "PAL."

Entire disposition with an overall loss. If you made an entire disposition of your interest in a passive activity and that activity had an overall loss, none of the gains, if any, or losses were entered on Form 8582 or the worksheets. However, all the gains and losses must be reported on the forms or schedules normally used. To the left of the entry space, enter "EDPA."

Entire disposition with an overall gain. Gains and losses from this activity were included on Form 8582 so that the gains might offset other PALs. Report all the gains and losses on the forms and schedules normally used, and to the left of the entry space, enter "EDPA."

Publicly Traded Partnerships (PTPs)

A PTP is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market (or its substantial equivalent).

An established securities market includes any national securities exchange and any local exchange registered under the Securities Exchange Act of 1934 or exempted from registration because of the limited volume of transactions. It also includes any over-the-counter market.

A secondary market generally exists if a person stands ready to make a market in the interest. An interest is treated as readily tradable if the interest is regularly quoted by persons, such as brokers or dealers, who are making a market in the interest.

The substantial equivalent of a secondary market exists if there is no identifiable market maker, but holders of interests have a readily available, regular, and ongoing opportunity to sell or exchange interests through a public means of obtaining or providing information on offers to buy, sell, or exchange interests. Similarly, the substantial equivalent of a secondary market exists if prospective buyers and sellers have the opportunity to buy, sell, or exchange interests in a timeframe and with the regularity and continuity that the existence of a market maker would provide.

Special Instructions for PTPs

Section 469(k) provides that the passive activity limitations must be applied separately to items from each PTP. PALs from a PTP generally may be used only to offset income or gain from passive activities of the same PTP. The special allowance (including CRDs) for rental real estate activities does not apply to PALs from a PTP.

Passive activity loss rules for partners in PTPs. Do not report passive income, gains, or losses from a PTP on Form 8582. Instead, use the following rules to figure and report your income, gains, and losses from passive activities you held through each PTP you owned during the tax year.

1. Combine any current year income, gains and losses, and any prior year unallowed losses to see if you have an overall loss from the PTP. Include only the same types of income and losses you would include to figure your net income or loss from a non-PTP passive activity. See *Passive Activity Income and Deductions* beginning on page 5.

2. If you have an overall gain, the net gain portion (total gain minus total losses) is nonpassive income.

It is important to figure the nonpassive income because it must be included in modified adjusted gross income to figure the special allowance for active participation in a non-PTP rental real estate activity on Form 8582. Also, you may be able to include the nonpassive income in investment interest expense deduction. See Form 4952, Investment Interest Expense Deduction.

Report all gains and allowed losses from the activity on the forms or schedules normally used, and to the left of each entry space, enter "From PTP."

Example. You have Schedule E income of \$8,000 and a Form 4797 prior year unallowed loss of \$3,500 from the passive activities of a PTP. You have a \$4,500 overall gain (\$8,000 – \$3,500) that is nonpassive income. On Schedule E, Part II, you report the \$4,500 net gain as nonpassive income in column (j). In column (g), you report the remaining Schedule E gain of \$3,500 (\$8,000 – \$4,500) as passive income. On the appropriate line of Form 4797, you report the prior year unallowed loss of \$3,500. You enter "From PTP" to the left of each entry space.

3. If you have an overall loss (but did not dispose of your entire interest in the PTP to an unrelated person in a fully taxable transaction during the year), the losses are allowed only to the extent of the income, and the excess loss is carried forward to use in a future year if you have income to offset it. Report as a passive loss on the schedule or form you normally use the portion of the loss equal to the income. Report the income as passive income on the form or schedule you normally use.

Example. You have a Schedule E loss of \$12,000 (current year losses plus prior year unallowed losses) and Form 4797 gain of \$7,200 from the passive activities of a PTP. You report the \$7,200 gain on the appropriate line of Form 4797. On Schedule E, Part II, you report \$7,200 of the losses as a passive loss in column (f). You carry forward the unallowed loss of \$4,800 (\$12,000 – \$7,200).

If you have unallowed losses from more than one activity of the PTP or from the same activity of the PTP that must be reported on different forms or schedules, allocate the unallowed losses on a pro rata basis to figure the amount allowed for each activity or on each form or schedule.

TIP To allocate and keep a record of the unallowed losses, use Worksheets 5, 6, and 7 of Form 8582.

List each activity of the PTP in Worksheet 5. Enter the overall loss from each activity in column (a). Complete column (b) of Worksheet 5 according to its instructions. Multiply the total unallowed loss from the PTP by each ratio in column (b) and enter the result in column (c) of Worksheet 5.

Next, complete Worksheet 6 for each activity listed in Worksheet 5 if all the loss from that activity is reported on one form or schedule. Use Worksheet 7 instead of Worksheet 6 for each activity with losses reported on two or more different forms or schedules (or on different parts of the same form or schedule). Enter the net loss plus any prior year unallowed losses in column (a) of Worksheet 6 (or Worksheet 7 if applicable). The losses in column (c) of Worksheet 6 (column (e) of Worksheet 7) are the allowed losses to report on your forms or schedules. Report these losses and any income from the PTP on the forms and schedules normally used.

4. If you have an overall loss and you disposed of your entire interest in the PTP to an unrelated person in a fully taxable transaction during the year, your losses (including prior year unallowed losses) allocable to the activity for the year are not limited by the passive loss rules. A fully taxable transaction is one in which you recognize all your realized gain or loss. Report the income and losses on the forms and schedules normally used.

For rules on the disposition of an entire interest reported using the installment method, see *Disposition of an Entire Interest* on page 7.

Paperwork Reduction Act Notice.

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual

taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown below.

Recordkeeping	26 min.
Learning about the law or the form	1 hr., 43 min.
Preparing the form	1 hr., 43 min.
Copying, assembling, and sending the form to the IRS	48 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

Department of the Treasury
Internal Revenue Service (99)

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

Name(s) shown on return

Identifying number

Part I 2010 Passive Activity Loss

Caution: Complete Worksheets 1, 2, and 3 on page 2 before completing Part I.

Rental Real Estate Activities With Active Participation (For the definition of active participation, see **Special Allowance for Rental Real Estate Activities** on page 3 of the instructions.)

1a Activities with net income (enter the amount from Worksheet 1, column (a))	1a		
b Activities with net loss (enter the amount from Worksheet 1, column (b))	1b	()
c Prior years unallowed losses (enter the amount from Worksheet 1, column (c))	1c	()
d Combine lines 1a, 1b, and 1c	1d		

Commercial Revitalization Deductions From Rental Real Estate Activities

2a Commercial revitalization deductions from Worksheet 2, column (a)	2a	()
b Prior year unallowed commercial revitalization deductions from Worksheet 2, column (b)	2b	()
c Add lines 2a and 2b	2c	()

All Other Passive Activities

3a Activities with net income (enter the amount from Worksheet 3, column (a))	3a		
b Activities with net loss (enter the amount from Worksheet 3, column (b))	3b	()
c Prior years unallowed losses (enter the amount from Worksheet 3, column (c))	3c	()
d Combine lines 3a, 3b, and 3c	3d		

4 Combine lines 1d, 2c, and 3d. If the result is net income or zero, all losses are allowed, including any prior year unallowed losses entered on line 1c, 2b, or 3c. Do not complete Form 8582. Report the losses on the forms and schedules normally used	4		
---	----------	--	--

If line 4 is a loss and:

- Line 1d is a loss, go to Part II.
- Line 2c is a loss (and line 1d is zero or more), skip Part II and go to Part III.
- Line 3d is a loss (and lines 1d and 2c are zero or more), skip Parts II and III and go to line 15.

Caution: If your filing status is married filing separately and you lived with your spouse at any time during the year, **do not** complete Part II or Part III. Instead, go to line 15.

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

Note: Enter all numbers in Part II as positive amounts. See page 9 of the instructions for an example.

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

If line 2c is a loss, go to Part III. Otherwise, go to line 15.

Part III Special Allowance for Commercial Revitalization Deductions From Rental Real Estate Activities

Note: Enter all numbers in Part III as positive amounts. See the example for Part II on page 9 of the instructions.

11 Enter \$25,000 reduced by the amount, if any, on line 10. If married filing separately, see instructions	11		
12 Enter the loss from line 4	12		
13 Reduce line 12 by the amount on line 10	13		
14 Enter the smallest of line 2c (treated as a positive amount), line 11, or line 13	14		

Part IV Total Losses Allowed

15 Add the income, if any, on lines 1a and 3a and enter the total	15		
16 Total losses allowed from all passive activities for 2010. Add lines 10, 14, and 15. See page 11 of the instructions to find out how to report the losses on your tax return	16		

Caution: *The worksheets must be filed with your tax return. Keep a copy for your records.*

Worksheet 1—For Form 8582, Lines 1a, 1b, and 1c (See page 8 of the instructions.)

Name of activity	Current year		Prior years	Overall gain or loss	
	(a) Net income (line 1a)	(b) Net loss (line 1b)	(c) Unallowed loss (line 1c)	(d) Gain	(e) Loss
Total. Enter on Form 8582, lines 1a, 1b, and 1c ▶					

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

Name of activity	(a) Current year deductions (line 2a)	(b) Prior year unallowed deductions (line 2b)	(c) Overall loss
Total. Enter on Form 8582, lines 2a and 2b ▶			

Worksheet 3—For Form 8582, Lines 3a, 3b, and 3c (See page 8 of the instructions.)

Name of activity	Current year		Prior years	Overall gain or loss	
	(a) Net income (line 3a)	(b) Net loss (line 3b)	(c) Unallowed loss (line 3c)	(d) Gain	(e) Loss
Total. Enter on Form 8582, lines 3a, 3b, and 3c ▶					

Worksheet 4—Use this worksheet if an amount is shown on Form 8582, line 10 or 14 (See page 9 of the instructions.)

Name of activity	Form or schedule and line number to be reported on (see instructions)	(a) Loss	(b) Ratio	(c) Special allowance	(d) Subtract column (c) from column (a)
Total ▶					

Worksheet 5—Allocation of Unallowed Losses (See page 10 of the instructions.)

Name of activity	Form or schedule and line number to be reported on (see instructions)	(a) Loss	(b) Ratio	(c) Unallowed loss
Total ▶				

Worksheet 6—Allowed Losses (See page 10 of the instructions.)

Name of activity	Form or schedule and line number to be reported on (see instructions)	(a) Loss	(b) Unallowed loss	(c) Allowed loss
Total ▶				

Worksheet 7—Activities With Losses Reported on Two or More Forms or Schedules (See page 10 of the instructions.)

Name of activity:	(a)	(b)	(c) Ratio	(d) Unallowed loss	(e) Allowed loss
Form or schedule and line number to be reported on (see instructions):					
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 and line number to be reported on (see instructions):					
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 and line number to be reported on (see instructions):					
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 ▶					