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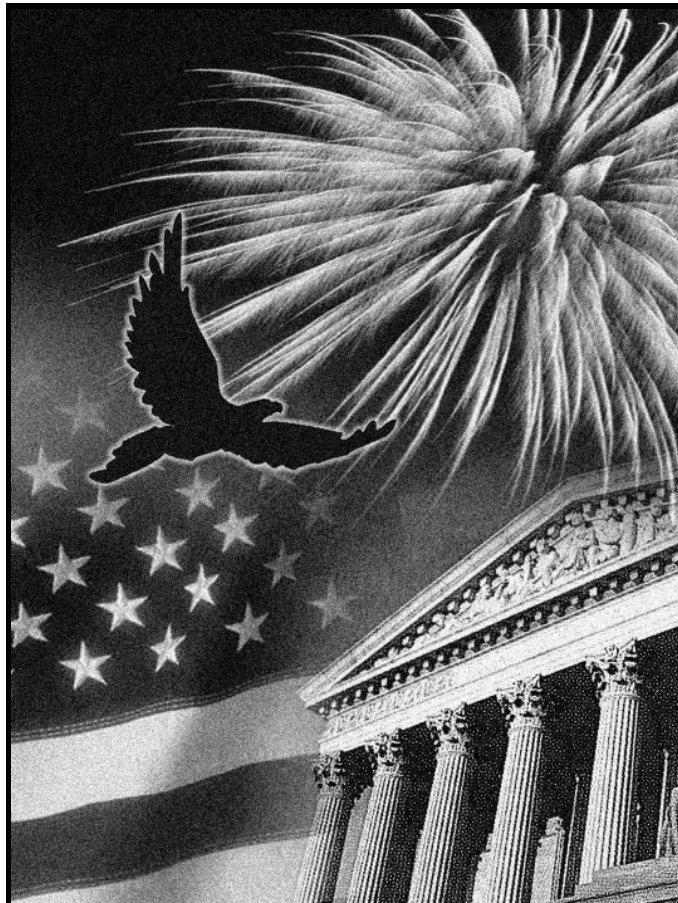
Internal  
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Service

**Publication 925**

Cat. No. 64265X

# Passive Activity and At-Risk Rules

For use in preparing  
**2011** Returns



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## What's New

**Future developments.** The IRS has created a page on IRS.gov for information about Publication 925, at [www.irs.gov/pub925](http://www.irs.gov/pub925). Information about any future developments affecting Publication 925 (such as legislation enacted after we release it) will be posted on that page.

## Reminders

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

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

**Photographs of missing children.** The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on

pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

## Introduction

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

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

You can write to us at the following address:

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

You can email us at [taxforms@irs.gov](mailto:taxforms@irs.gov). Please put "Publications Comment" on the subject line. You can also send us comments from [www.irs.gov/formspubs/](http://www.irs.gov/formspubs/). Select "Comment on Tax Forms and Publications" under "Information about."

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**Tax questions.** If you have a tax question, check the information available on IRS.gov or call 1-800-829-1040. We cannot answer tax questions sent to either of the above addresses.

## Useful Items

You may want to see:

### Publication

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

### Form (and Instructions)

- 4952 Investment Interest Expense Deduction
- 6198 At-Risk Limitations
- 8582 Passive Activity Loss Limitations

- 8582-CR Passive Activity Credit Limitations
- 8810 Corporate Passive Activity Loss and Credit Limitations
- 8949 Sales and Other Dispositions of Capital Assets

See [How To Get Tax Help](#) near the end of this publication for information about getting these publications and forms.

## Passive Activity Limits

In general, you can deduct passive activity losses only from passive activity income (a limit on loss deductions). You carry any excess loss forward to the following year or years until used, or until deducted in the year you dispose of your entire interest in the activity in a fully taxable transaction. See [Dispositions](#), later.



*Before applying this limit on passive activity losses, you must first determine the amount of your loss disallowed under the at-risk rules explained in the second part of this publication.*

**Passive activity credits.** You can subtract passive activity credits only from the tax on net passive income. Passive activity credits include the general business credit. Credits that are more than the tax on income from passive activities are carried forward.

Unallowed passive activity credits, unlike unallowed passive activity losses, cannot be claimed when you dispose of your entire interest in an activity. However, to determine your gain or loss from the disposition, you can elect to increase the basis of the credit property by the amount of the original basis reduction for the credit, to the extent that the credit was not allowed because of the passive activity limits. You cannot elect to adjust the basis for a partial disposition of your interest in a passive activity.

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

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

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

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

**Excess farm loss.** If you receive an applicable subsidy for any tax year and you have an excess farm loss for the tax year, special rules

apply. This does not apply to a C corporation. For information, see the Instructions for Schedule F (Form 1040), Profit or Loss From Farming.

## Who Must Use These Rules?

The passive activity rules apply to:

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

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

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

**Closely held corporation.** A closely held corporation can offset net active income with its passive activity loss. It also can offset the tax attributable to its net active income with its passive activity credits. However, a closely held corporation cannot offset its portfolio income (defined later, under *Passive Activity Income*) with its passive activity loss.

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

## Passive Activities

There are two kinds of passive activities.

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

Material participation in a trade or business is discussed later, under [Activities That Are Not Passive Activities](#).

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

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

## Trade or Business Activities

A trade or business activity is an activity that:

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

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

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

## Rental Activities

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

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

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

- a. Services needed to permit the lawful use of the property,
  - b. Services to repair or improve property that would extend its useful life for a period substantially longer than the average rental, and
  - c. Services that are similar to those commonly provided with long-term rentals of real estate, such as cleaning and maintenance of common areas or routine repairs.
3. You provide extraordinary personal services in making the rental property available for customer use. Services are extraordinary personal services if they are performed by individuals and the customers' use of the property is incidental to their receipt of the services.
  4. The rental is incidental to a nonrental activity. The rental of property is incidental to an activity of holding property for investment if the main purpose of holding the property is to realize a gain from its appreciation and the gross rental income from the property is less than 2% of the smaller of the property's unadjusted basis or fair market value. The unadjusted basis of property is its cost not reduced by depreciation or any other basis adjustment. The rental of property is incidental to a trade or business activity if all of the following apply.

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



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

**Special \$25,000 allowance.** If you or your spouse actively participated in a passive rental real estate activity, you can deduct up to \$25,000 of loss from the activity from your nonpassive income. This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities. Similarly, you can offset credits from the

activity against the tax on up to \$25,000 of nonpassive income after taking into account any losses allowed under this exception.

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

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

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

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



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

You can claim a current year CRD for 2011, only if you, or a pass-through entity in which you were a partner or shareholder, had a CRD for a building placed in service before 2010 and elected to amortize the CRD over a period of 120 months that included all or part of 2011. The portion of that CRD that would be deductible in the current year should be reported as a current year CRD with a notation as to the origination of the amount.

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

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

A decedent's qualified revocable trust can also be treated as actively participating if both the trustee and the executor (if any) of the estate choose to treat the trust as part of the estate.



The choice applies to tax years ending after the decedent's death and before:

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

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

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

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

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

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

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

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

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

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

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

- Taxable social security and tier 1 railroad retirement benefits.
- Deductible contributions to individual retirement accounts (IRAs) and section 501(c)(18) pension plans.
- The exclusion from income of interest from qualified U.S. savings bonds used to pay qualified higher education expenses.
- The exclusion from income of amounts received from an employer's adoption assistance program.
- Passive activity income or loss included on Form 8582.
- Any rental real estate loss allowed because you materially participated in the rental activity as a [real estate professional](#)

(as discussed later, under *Activities That Are Not Passive Activities*).

- Any overall loss from a publicly traded partnership (see *Publicly Traded Partnerships (PTPs)* in the instructions for Form 8582).
- The deduction for the employer-equivalent portion of self-employment tax.
- The deduction for domestic production activities.
- The deduction allowed for interest on student loans.
- The deduction for qualified tuition and related expenses.

**Example.** During 2011, John was unmarried and was not a real estate professional. For 2011, he had \$120,000 in salary and a \$31,000 loss from his rental real estate activities in which he actively participated. His modified adjusted gross income is \$120,000. When he files his 2011 return, he can deduct only \$15,000 of his passive activity loss. He must carry over the remaining \$16,000 passive activity loss to 2012. He figures his deduction and carryover as follows:

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

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

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

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

1. The portion of passive activity losses not attributable to the CRD.

2. The portion of passive activity losses attributable to the CRD.
3. The portion of passive activity credits attributable to credits other than the rehabilitation and low-income housing credits.
4. The portion of passive activity credits attributable to the rehabilitation credit.
5. The portion of passive activity credits attributable to the low-income housing credit.

## Activities That Are Not Passive Activities

The following are not passive activities.

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



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

## Material Participation

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

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

1. You participated in the activity for more than 500 hours.
2. Your participation was substantially all the participation in the activity of all individuals for the tax year, including the participation of individuals who did not own any interest in the activity.

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

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

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

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

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

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

**Participation as an investor.** You do not treat the work you do in your capacity as an investor in an activity as participation unless you

are directly involved in the day-to-day management or operations of the activity. Work you do as an investor includes:

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

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



**Proof of participation.** You can use any reasonable method to prove your participation in an activity for the year.

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

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

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

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

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

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

## Real Estate Professional

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

If you qualified as a real estate professional for 2011, report income or losses from rental real estate activities in which you materially participated as nonpassive income or losses, and complete line 43 of Schedule E (Form 1040). If you also have an unallowed loss from these activities from an earlier year when you did not qualify, see [Treatment of former passive activities](#) under *Passive Activities*, earlier.

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

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

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

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

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

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

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

## Passive Activity Income and Deductions

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

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

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

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

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

### Passive Activity Income

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

Passive activity income does not include the following items.

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

- Income from an oil or gas property if you treated any loss from a working interest in the property for any tax year beginning after 1986 as a nonpassive loss, as discussed in item (2) under [Activities That Are Not Passive Activities](#), earlier. This also applies to income from other oil and gas property the basis of which is determined wholly or partly by the basis of the property in the preceding sentence.
- Any income from intangible property, such as a patent, copyright, or literary, musical, or artistic composition, if your personal efforts significantly contributed to the creation of the property.
- Any other income that must be treated as nonpassive income. See [Recharacterization of Passive Income](#), later.
- Overall gain from any interest in a publicly traded partnership. See [Publicly Traded Partnerships \(PTPs\)](#) in the instructions for Form 8582.
- State, local, and foreign income tax refunds.
- Income from a covenant not to compete.
- Reimbursement of a casualty or theft loss included in gross income to recover all or part of a prior year loss deduction, if the loss deduction was not a passive activity deduction.
- Alaska Permanent Fund dividends.
- Cancellation of debt income, if at the time the debt is discharged the debt is not allocated to passive activities under the interest expense allocation rules. See chapter 4 of Publication 535, Business Expenses, for information about the rules for allocating interest.

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

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

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

- \$10,000, or
- 10% of the total of the fair market value of your interest in the property and the fair market value of all other property used in

that activity immediately before the disposition.

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

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

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

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

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

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

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

### Passive Activity Deductions

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 passive loss rules in prior tax years and carried



forward to the current tax year. They also include losses from dispositions 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.

Passive activity deductions do not include the following items.

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

## Grouping Your Activities

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

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

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

## Appropriate Economic Units

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

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

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

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

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

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

However, if the original grouping is clearly inappropriate or there is a material change in the facts and circumstances that makes the original

grouping clearly inappropriate, you must regroup the activities and comply with any disclosure requirements of the IRS.

See [Disclosure Requirement](#), later.

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

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

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

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

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

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

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

- Holding, producing, or distributing motion picture films or video tapes.
- Farming.
- Leasing any section 1245 property (as defined in section 1245(a)(3) of the Internal Revenue Code). For a list of section 1245 property, see [Section 1245 property](#) under

*Activities Covered by the At-Risk Rules*, later.

- Exploring for, or exploiting, oil and gas resources.
- Exploring for, or exploiting, geothermal deposits.

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

**Limited entrepreneur.** A limited entrepreneur is a person who:

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

#### **Activities conducted through another entity.**

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

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



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

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

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

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

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

## **Disclosure Requirement**

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

**New grouping.** You must file a written statement with your original income tax return for the first tax year in which two or more activities are originally grouped into a single activity. The statement must provide the names, addresses, and employer identification numbers (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.

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

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

- Groups together any of the activities that the entity does not group together,

- Groups the entity's activities with activities conducted directly by the partner or shareholder, or
- Groups an entity's activities with activities conducted through another entity.

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

## **Recharacterization of Passive Income**

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

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

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

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

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

#### **Limit on recharacterized passive income.**

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

#### **Investment income and investment expense.**

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



## Significant Participation Passive Activities

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

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

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

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

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

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

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

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

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

Enter -0- here if the prior year unallowed loss is the same as the current year net income.

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

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

**Worksheet B.** On [Worksheet B](#), later, list only the significant participation passive activities that have net income as shown in column (c) of Worksheet A.

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

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

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

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

## Rental of Nondepreciable Property

If you have net passive income (including prior year unallowed losses) from renting property in

a rental activity, and less than 30% of the unadjusted basis of the property is subject to depreciation, you treat the net passive income as nonpassive income.

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

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

## Equity-Financed Lending Activities

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

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

## Rental of Property Incidental to a Development Activity

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

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

## Worksheet A. Significant Participation Passive Activities

Keep for Your Records 

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

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

## Rental of Property to a Nonpassive Activity

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

## Licensing of Intangible Property by Pass-Through Entities

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

This recharacterization rule does not apply if:

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

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

## Dispositions

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



*If you have a capital loss on the disposition of an interest in a passive activity, the loss may be limited by the capital loss rules. The limit is generally \$3,000 for individuals (\$1,500 in the case of married individuals filing separate returns). See Publication 544, Sales and Other Dispositions of Assets, for more information.*

**Example.** Ray earned a \$60,000 salary and owned one passive activity through a 5% interest in the B Limited Partnership. In 2011, he sold his entire partnership interest to an unrelated person for \$30,000. His adjusted basis in the partnership interest was \$42,000, and he had carried over \$2,000 of passive activity losses from the activity.

Ray's deductible loss for 2011 is \$5,000, figured as follows:

Sales price . . . . .	\$30,000
Minus: adjusted basis . . . . .	<u>42,000</u>
Capital loss . . . . .	\$12,000
Minus: capital loss limit . . . . .	<u>3,000</u>
Capital loss carryover . . . . .	<u>\$9,000</u>
Allowable capital loss on sale . . . . .	\$3,000
Carryover losses allowable . . . . .	<u>2,000</u>
Total current deductible loss . . . . .	<u>\$5,000</u>

Ray deducts the \$5,000 total current deductible loss in 2011. He must carry over the remaining \$9,000 capital loss, which is not subject to the passive activity loss limit. He will treat it like any other capital loss carryover.

**Installment sale of an entire interest.** If you sell your entire interest in a passive activity through an installment sale, to figure the loss for the current year that is not limited by the passive

activity rules, multiply your overall loss (not including losses allowed in prior years) by a fraction. The numerator of the fraction is the gain recognized in the current year, and the denominator is the total gain from the sale minus all gains recognized in prior years.

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

### Partners and S corporation shareholders.

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

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

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

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

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

## Worksheet B. Significant Participation Activities With Net Income

Keep for Your Records



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

were allocable to the interest at the date of death, then the decedent's deduction for the tax year would be limited to \$2,000 (\$8,000 – \$6,000).

If you inherited property from a decedent who died in 2010, special rules may apply if the executor of the estate files Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent. For more information, see Publication 4895, Tax Treatment of Property Acquired from a Decedent Dying in 2010, and the Instructions for Form 8939.

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

## How To Report Your Passive Activity Loss

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

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

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

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## Comprehensive Example

The following example shows how to report your passive activities. In addition to Form 1040, U.S. Individual Income Tax Return, Charles and Lily Woods use Form 8582 (to figure allowed passive activity deductions), Schedule E (to report rental activities and partnership activities), Form 4797 (to figure the gain and allowable loss from assets sold that were used in the activities), and Form 8949 and Schedule D (to report the sale of partnership interests).

## General Information

Charles and Lily are married, file a joint return, and have combined wages of \$132,000 in 2011. They own interests in the activities listed below. They are at risk for their investment in the activities. They did not materially participate in any of the business activities. They actively participated in the rental real estate activities in 2011 and all prior years. Charles and Lily are not real estate professionals.

1. Activity A is a rental real estate activity. The income and expenses are reported on Schedule E. Charles and Lily's records show a loss from operations of \$15,000 in 2011. Their records also show a gain of \$2,776 from the sale in January 2011 of section 1231 assets used in the activity. The section 1231 gain is reported in Part I of Form 4797 and is identified as being from a passive activity (FPA). For 2010, they completed the worksheets for Form 8582 and calculated that \$6,667 of Activity A's Schedule E loss for 2010 was disallowed by the passive activity rules. That loss is carried over to 2011 as a prior year unallowed loss and will be used to figure the allowed loss for 2011.
2. Activity B is a rental real estate activity. Its income and expenses are reported on Schedule E. Charles and Lily's records show a loss from operations of \$11,600 in 2011. For 2010, they completed the worksheets for Form 8582 and calculated that \$8,225 of Activity B's Schedule E loss for 2010 was disallowed by the passive activity rules. That loss is carried over to 2011 as a prior year unallowed loss and will be used to figure the allowed loss for 2011.
3. Partnership #1 is a trade or business activity and is not a publicly traded partnership (PTP). Partnership #1 reports a \$4,000 distributive share of its 2011 profits to Charles and Lily in box 1 of Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc. They report that profit on Schedule E. For 2010, they completed the worksheets for Form 8582 and calculated that \$2,600 of their distributive share of the loss from Partnership #1 in 2010 was disallowed by the passive activity rules. That loss is carried over to 2011 as a prior year unallowed loss and will be used to figure the allowed loss for 2011.
4. Partnership #2 is a trade or business activity and also a PTP. In December 2011, Charles and Lily sold their entire interest in Partnership #2. To indicate they made an entire disposition of a passive activity, they enter EDPA on the appropriate lines. They do not report that sale on Form 8582 because Partnership #2 is a PTP. They recognize a long-term capital gain of \$15,300 (\$25,300 selling price minus \$10,000 adjusted basis). They report the transaction in Part II of Form 8949 and check box C. The selling price and adjusted basis from this transaction are combined with their other transactions for 2011 and carried to Schedule D (Form 1040), Part II, line 10. The partnership reports a \$1,200 distributive share of its 2011 losses to them in box

1 of Schedule K-1 (Form 1065). They report that loss on Schedule E. For 2010, they followed the instructions for Form 8582 and calculated that \$2,445 of their distributive share of Partnership #2's 2010 loss was disallowed by the passive activity rules. That loss is carried over from 2010 and reported on Schedule E as a loss for 2011. (For a discussion of PTPs, see the instructions for Form 8582.)

5. Partnership #3 is a single trade or business activity and is not a PTP. Charles and Lily's distributive share of partnership losses for 2011 reported in box 1 of Schedule K-1 (Form 1065) is \$6,000. Charles and Lily sold their entire interest in Partnership #3 in November 2011. To indicate they made an entire disposition of a passive activity, they enter EDPA on the appropriate lines. They report the \$15,000 selling price and \$11,000 adjusted basis in Part II of Form 8949. They check box C at the top of Form 8949 because they did not receive a Form 1099-B. The amounts reported are combined with their other transactions and carried to Schedule D (Form 1040), Part II, line 10. For 2010, they completed the worksheets for Form 8582 and calculated that \$3,000 of their distributive share of the partnership's loss for 2010 was disallowed by the passive activity rules. That loss is carried over to 2011 as a prior year unallowed Schedule E loss.
6. Partnership #4 is a trade or business activity that is a limited partnership. Charles and Lily are limited partners who did not meet any of the material participation tests. Their distributive share of 2011 partnership loss, reported in box 1 of Schedule K-1 (Form 1065), is \$2,400. For 2010, they completed the worksheets for Form 8582 and calculated that \$1,500 of their distributive share of loss for 2010 was disallowed by the passive activity rules. That loss is carried over to 2011 as a prior year unallowed loss and will be used to figure the allowed loss for 2011.

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

For 2011, Charles and Lily complete the forms they usually use to report income or expenses from their activities. They enter their combined wages, \$132,000, on Form 1040. They complete Form 8949, Part II, with the information from the sales of Partnerships #2 and #3. Because they did not receive a Form 1099-B, they check box C at the top of Part II and use one Form 8949 (sales price of \$40,300, and cost or other basis of \$21,000) to line 10 of Schedule D (Form 1040). The completed line 10 shows a long-term capital gain of \$19,300 from the sales of Partnerships #2 and #3. Partnership #2 is a PTP so it is not entered on Form 8582. The disposition of Partnership #3 is a disposition of an entire interest in an activity with an overall loss of \$5,000 (\$4,000 – \$3,000 – \$6,000) so that partnership also is not entered on Form 8582. They combine the PTP \$1,200 current



year loss with its \$2,445 prior year loss and report the combined amount in column (f) on Schedule E, Part II, line 28. They also combine the Partnership #3 \$6,000 current year loss with its \$3,000 prior year loss, and enter the combined amount in column (h) on Schedule E, Part II, line 28, because they have an overall loss from that activity. Normally, current year and prior year losses should be entered on separate lines of Schedule E. For purposes of this example only, the amounts have been combined on one line. They enter the \$4,000 profit from Partnership #1 in column (g). Before completing the rest of Schedule E, Part II, they must complete Form 8582 to figure out how much of their losses from Partnerships #1 and #4 they can deduct.

They complete Schedule E, Part I, through line 22. Their rental activities are passive so they must complete Form 8582 to figure the deductible losses to enter on line 23.

They enter the gain from the sale of the section 1231 assets of Activity A on Form 4797.

## Step Two—Form 8582 and Its Worksheets

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

**Worksheet 1.** Worksheet 1 is for rental real estate activities with active participation. Charles and Lily enter the gains and losses from Activity A and Activity B on Worksheet 1. They enter all amounts from the activities even though they already reported the gain of \$2,776 from Activity A on Form 4797 because all income or loss from these activities must be taken into account to figure the loss allowed.

1. They write "Activity A" on the first line under "Name of activity." Then they enter:
  - a. \$2,776 gain in column (a) from Form 4797, line 2, column (g),
  - b. (\$15,000) loss in column (b) from Schedule E, line 21, column A, and
  - c. (\$6,667) prior year unallowed loss in column (c) from their 2010 worksheets.

They combine the three amounts. The result, (\$18,891), is an overall loss so they enter it in column (e).

2. Charles and Lily write "Activity B" on the second line under "Name of activity." Then they enter:
  - a. (\$11,600) loss in column (b) from Schedule E, line 21, column B, and
  - b. (\$8,225) prior year unallowed loss in column (c) from their 2010 worksheets.

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

3. They separately add the amounts in columns (a), (b), and (c).
  - a. They enter \$2,776 in column (a) on the *Total* line and also on Form 8582, Part I, line 1a.

- b. They enter (\$26,600) in column (b) on the *Total* line and also on Form 8582, Part I, line 1b.
  - c. They enter (\$14,892) in column (c) on the *Total* line and also on Form 8582, Part I, line 1c.
4. They combine lines 1a, 1b, and 1c, Form 8582, and put the net loss, (\$38,716), on line 1d.

**Worksheet 3.** Partnership #1 and Partnership #4 are nonrental passive activities, so Charles and Lily enter the appropriate information about those activities on Worksheet 3 in the same way they reported their rental activities on Worksheet 1. Then they enter the totals on Form 8582, Part I, lines 3a through 3d.

**Reporting income from column (d), Worksheets 1 and 3.** Activities that have an overall gain in column (d) are not used any further in the calculations for Form 8582. At this point, all income and losses from those activities should be entered on the forms or schedules that would normally be used. Charles and Lily have one activity with an overall gain (\$4,000 – \$2,600 = \$1,400). This is Partnership #1, which is shown in Worksheet 3. They already reported the \$4,000 income from this activity on Schedule E, Part II. They now enter the entire \$2,600 loss on Schedule E, Part II, as well.

## Step Three—Completing Form 8582

Next, Charles and Lily complete Form 8582, Part II, to determine the amount they can deduct for their net losses from real estate activities with active participation (Activities A and B). They enter all amounts as though they were positive (without brackets around losses). They then complete Form 8582, Part IV.

- They enter \$38,716 on line 5 since this is the smaller of the loss on line 1d or the loss on line 4.
- They enter \$150,000 on line 6 since they are married and filing a joint return.
- They enter \$138,655, their modified adjusted gross income, on line 7. (See discussion of modified adjusted gross income, earlier.) The \$138,655 is made up of their wages, \$132,000, plus their overall gain of \$11,655 from Partnership #2, a PTP, less their \$5,000 overall loss from Partnership #3. On Schedule D, they reported long-term gains of \$15,300 from the PTP disposition and \$4,000 from the Partnership #3 disposition. On Schedule E, they combined the PTP 2011 loss of \$1,200 with its 2010 loss of \$2,445, and combined the Partnership #3 2011 loss of \$6,000 with its 2010 loss of \$3,000. Netting these amounts gives them the PTP overall gain of \$11,655 (\$15,300 – \$1,200 – \$2,445) and the Partnership #3 overall loss of \$5,000 (\$4,000 – \$6,000 – \$3,000) that were used in figuring modified adjusted gross income.
- They subtract line 7 from line 6 and enter the result, \$11,345, on line 8.

- They multiply line 8 by 50% and enter the result, \$5,673, on line 9.
- They enter the smaller of line 5 or line 9, \$5,673, on line 10.
- They add the income on lines 1a and 3a and enter the result, \$6,776, on line 15.
- They add lines 10 and 15 and enter the result, \$12,449, on line 16.

## Step Four—Completing Worksheet 4

Charles and Lily must complete Worksheet 4 because they entered an amount on Form 8582, line 10, and have two activities, each with an overall loss in Worksheet 1, column (e). Worksheet 4 allocates the amount on line 10 (their special allowance for active participation rental real estate activities) between Activity A and Activity B.

- In the two left columns, they write the name of each activity, A and B, and the schedule and line number on which each activity is reported.
- They fill in column (a) with the losses from Worksheet 1, column (e). They add up the amounts, and enter the result, \$38,716, in the *Total* line without brackets.
- They figure the ratios for column (b) by dividing each amount in column (a) by the amount on the column (a) *Total* line. They enter each result in column (b). The total of the ratios must equal 1.00.
- They multiply the amount from line 10, Form 8582, \$5,673, by each of the ratios in Worksheet 4, column (b) and enter the results on the appropriate line in column (c). The total must equal \$5,673.
- They subtract column (c) from column (a) and enter each result in column (d).

## Step Five—Completing Worksheet 5

Worksheet 5 must be completed if any activity has an overall loss in Worksheet 3, column (e), or a loss in Worksheet 4, column (d) (or Worksheet 1, column (e), if Worksheet 4 was not needed). This worksheet allocates the unallowed loss among the activities with an overall loss. Charles and Lily complete Worksheet 5 with the activities from Worksheet 4 and the one activity showing a loss in Worksheet 3, column (e). They write the name of each activity and the schedule or form and the line number on which each loss will be reported in the two left columns of Worksheet 5.

1. In column (a), they enter the losses from Worksheet 3, column (e) and Worksheet 4, column (d). These losses are entered as positive numbers, not in brackets. They add the numbers and enter the total, \$36,943, on the *Total* line.
2. They divide each of the losses in column (a) by the amount on the column (a) *Total* line, and enter each result in column (b). The ratios must total 1.00.

3. Now they use the computation worksheet for column (c) (see the worksheet in the instructions for Form 8582) to figure the unallowed loss to allocate in column (c).
  - a. On line A of the computation worksheet, they enter the amount from line 4 of Form 8582, \$41,216, as a positive number.
  - b. On line B, they enter the amount from line 10 of Form 8582, \$5,673.
  - c. They subtract line B from line A and enter the result, \$35,543, on line C. This is the total unallowed loss.

They multiply line C, \$35,543, by each of the ratios in column (b) and enter the results in column (c). These amounts are the unallowed losses from each activity and must add up to \$35,543.

### Step Six—Using Worksheets 6 and 7

Charles and Lily now decide whether they must use Worksheet 6, Worksheet 7, or both to figure their allowed losses. If the loss from any activity entered on Worksheet 5 is reported on only one form or schedule, then Worksheet 6 is used for

that activity. If an activity has a loss that is reported on two or more schedules or forms (for example, a loss that must be reported partly on Schedule C and partly on Form 4797), Worksheet 7 is used for that activity. All of the activities Charles and Lily entered on Worksheet 5 will be reported on Schedule E. Therefore, they use Worksheet 6 to figure the allowed loss for each activity.

**Worksheet 6.** They complete Worksheet 6 with the activities from Worksheet 5.

- They write the name of each activity and the schedule and line number to be used in the two left columns of Worksheet 6.
- In column (a), they enter the total loss for each activity. This includes the current year loss plus the prior year unallowed loss. They find these amounts by adding columns (b) and (c) on Worksheets 1 and 3.
- In column (b), they enter the unallowed loss for each activity already figured in Worksheet 5, column (c). They must save this information to use next year in figuring their passive losses.
- In column (c), they figure their allowed losses for 2011 by subtracting their unallowed losses, column (b), from their total

losses, column (a). These allowed losses are entered on the appropriate schedules.

**Reporting allowed losses.** Charles and Lily enter their allowed losses from Activities A and B on Schedule E, Part I, line 22, because these are rental properties. They report their allowed loss from Partnership #4 on Schedule E, Part II, line 28D.

### Step Seven—Finishing the Reporting of the Passive Activities

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

- The total Schedule D gain, \$22,076, on line 13, and
- The Schedule E loss, (\$21,094), on line 17.

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

For the year Jan. 1–Dec. 31, 2011, or other tax year beginning , 2011, ending , 20
Your first name and initial Charles Last name Woods
If a joint return, spouse's first name and initial Lily Last name Woods
Home address (number and street). If you have a P.O. box, see instructions. 6925 Country Road Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). Anytown, VA 22306
Foreign country name Foreign province/county Foreign postal code
Presidential Election Campaign
Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. [X] You [X] Spouse

Filing Status
1 [ ] Single
2 [X] Married filing jointly (even if only one had income)
3 [ ] Married filing separately. Enter spouse's SSN above and full name here.
4 [ ] Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here.
5 [ ] Qualifying widow(er) with dependent child

Exemptions
6a [X] Yourself. If someone can claim you as a dependent, do not check box 6a.
6b [X] Spouse
c Dependents:
(1) First name Last name (2) Dependent's social security number (3) Dependent's relationship to you (4) [X] if child under age 17 qualifying for child tax credit (see instructions)
d Total number of exemptions claimed 2

Income
7 Wages, salaries, tips, etc. Attach Form(s) W-2 7 132,000
8a Taxable interest. Attach Schedule B if required 8a
b Tax-exempt interest. Do not include on line 8a 8b
9a Ordinary dividends. Attach Schedule B if required 9a
b Qualified dividends 9b
10 Taxable refunds, credits, or offsets of state and local income taxes 10
11 Alimony received 11
12 Business income or (loss). Attach Schedule C or C-EZ 12
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here [ ] 13 22,076
14 Other gains or (losses). Attach Form 4797 14
15a IRA distributions 15a b Taxable amount 15b
16a Pensions and annuities 16a b Taxable amount 16b
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E 17 (21,094)
18 Farm income or (loss). Attach Schedule F 18
19 Unemployment compensation 19
20a Social security benefits 20a b Taxable amount 20b
21 Other income. List type and amount 21
22 Combine the amounts in the far right column for lines 7 through 21. This is your total income 22 132,982

Adjusted Gross Income
23 Educator expenses 23
24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ 24
25 Health savings account deduction. Attach Form 8889 25
26 Moving expenses. Attach Form 3903 26
27 Deductible part of self-employment tax. Attach Schedule SE 27
28 Self-employed SEP, SIMPLE, and qualified plans 28
29 Self-employed health insurance deduction 29
30 Penalty on early withdrawal of savings 30
31a Alimony paid b Recipient's SSN 31a
32 IRA deduction 32
33 Student loan interest deduction 33
34 Tuition and fees. Attach Form 8917 34
35 Domestic production activities deduction. Attach Form 8903 35
36 Add lines 23 through 35 36
37 Subtract line 36 from line 22. This is your adjusted gross income 37 132,982



**SCHEDULE D  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Capital Gains and Losses**

▶ **Attach to Form 1040 or Form 1040NR.** ▶ **See Instructions for Schedule D (Form 1040).**  
▶ **Use Form 8949 to list your transactions for lines 1, 2, 3, 8, 9, and 10.**

OMB No. 1545-0074

**2011**  
Attachment  
Sequence No. **12**

Name(s) shown on return

Charles and Lily Woods

Your social security number

123-00-4567

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

Complete Form 8949 before completing line 1, 2, or 3. This form may be easier to complete if you round off cents to whole dollars.	(e) Sales price from Form(s) 8949, line 2, column (e)	(f) Cost or other basis from Form(s) 8949, line 2, column (f)	(g) Adjustments to gain or loss from Form(s) 8949, line 2, column (g)	(h) Gain or (loss) Combine columns (e), (f), and (g)
<b>1</b> Short-term totals from all Forms 8949 with <b>box A</b> checked in <b>Part I</b> . . . . .		( )		
<b>2</b> Short-term totals from all Forms 8949 with <b>box B</b> checked in <b>Part I</b> . . . . .		( )		
<b>3</b> Short-term totals from all Forms 8949 with <b>box C</b> checked in <b>Part I</b> . . . . .		( )		
<b>4</b> Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 . . . . .				<b>4</b>
<b>5</b> Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .				<b>5</b>
<b>6</b> Short-term capital loss carryover. Enter the amount, if any, from line 8 of your <b>Capital Loss Carryover Worksheet</b> in the instructions . . . . .				<b>6</b> ( )
<b>7</b> <b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back . . . . .				<b>7</b>

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

Complete Form 8949 before completing line 8, 9, or 10. This form may be easier to complete if you round off cents to whole dollars.	(e) Sales price from Form(s) 8949, line 4, column (e)	(f) Cost or other basis from Form(s) 8949, line 4, column (f)	(g) Adjustments to gain or loss from Form(s) 8949, line 4, column (g)	(h) Gain or (loss) Combine columns (e), (f), and (g)
<b>8</b> Long-term totals from all Forms 8949 with <b>box A</b> checked in <b>Part II</b> . . . . .		( )		
<b>9</b> Long-term totals from all Forms 8949 with <b>box B</b> checked in <b>Part II</b> . . . . .		( )		
<b>10</b> Long-term totals from all Forms 8949 with <b>box C</b> checked in <b>Part II</b> . . . . .	40,300	( 21,000 )		19,300
<b>11</b> Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824 . . . . .				<b>11</b> 2,776
<b>12</b> Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .				<b>12</b>
<b>13</b> Capital gain distributions. See the instructions . . . . .				<b>13</b>
<b>14</b> Long-term capital loss carryover. Enter the amount, if any, from line 13 of your <b>Capital Loss Carryover Worksheet</b> in the instructions . . . . .				<b>14</b> ( )
<b>15</b> <b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (h). Then go to Part III on the back . . . . .				<b>15</b> 22,076

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 11338H

Schedule D (Form 1040) 2011

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

Your social security number

Charles and Lily Woods

123-00-4567

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

**Note:** You **must** check **one** of the boxes below. Complete a *separate* Form 8949, page 2, for **each** box that is checked.

**\*Caution.** Do not complete column (b) or (g) until you have read the instructions for those columns (see the Instructions for Schedule D (Form 1040)). Columns (b) and (g) do not apply for most transactions and should generally be left blank.

- (A)** Long-term transactions reported on Form 1099-B with basis reported to the IRS
  **(B)** Long-term transactions reported on Form 1099-B but basis not reported to the IRS
  **(C)** Long-term transactions for which you cannot check box A or B

3	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Code, if any, for column (g)*	(c) Date acquired (Mo., day, yr.)	(d) Date sold (Mo., day, yr.)	(e) Sales price (see instructions)	(f) Cost or other basis (see instructions)	(g) Adjustments to gain or loss, if any*
	Partnership #2 EDPA		12-02-05	12-02-11	25,300	10,000	
	Partnership #3 EDPA		12-15-06	11-18-11	15,000	11,000	
<b>4</b>	<b>Totals.</b> Add the amounts in columns (e) and (f). Also, combine the amounts in column (g). Enter here and include on Schedule D, <b>line 8</b> (if <b>box A</b> above is checked), <b>line 9</b> (if <b>box B</b> above is checked), or <b>line 10</b> (if <b>box C</b> above is checked) . . . . . ▶				40,300	21,000	

**SCHEDULE E  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Supplemental Income and Loss**

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

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

OMB No. 1545-0074

**2011**

Attachment  
Sequence No. **13**

Name(s) shown on return

Charles and Lily Woods

Your social security number

123-00-4567

- A** Did you make any payments in 2011 that would require you to file Form(s) 1099? (see instructions)  Yes  No  
**B** If "Yes," did you or will you file all required Forms 1099?  Yes  No

**Part I** **Income or Loss From Rental Real Estate and Royalties** **Note.** If you are in the business of renting personal property, use Schedule C or C-EZ (see instructions). If you are an individual, report farm rental income or loss from Form 4835 on page 2, line 40.

**Caution.** For each rental property listed on line 1, check the box in the last column only if you owned that property as a member of a qualified joint venture (QJV) reporting income not subject to self-employment tax.

1	Physical address of each property—street, city, state, zip	Type—from list below	2	Fair Rental Days	Personal Use Days	QJV
A	6924 Country Road, Anytown, VA 22306	1	For each rental real estate property listed, report the number of days rented at fair rental value and days with personal use. See instructions.	A 365	0	
B	6915 Country Road, Anytown, VA 22306	1		B 365	0	
C				C		

**Type of Property:**

- 1 Single Family Residence      3 Vacation/Short-Term Rental      5 Land      7 Self-Rental  
 2 Multi-Family Residence      4 Commercial      6 Royalties      8 Other (describe)

Income:		Properties		
		A	B	C
<b>3a</b>	Merchant card and third party payments. For 2011, enter -0-	<b>3a</b> -0-	-0-	
<b>b</b>	Payments not reported to you on line 3a . . . . .	<b>3b</b> 25,000	8,300	
<b>4</b>	Total not including amounts on line 3a that are not income (see instructions) . . . . .	<b>4</b> 25,000	8,300	
<b>Expenses:</b>				
<b>5</b>	Advertising . . . . .	<b>5</b> 600	210	
<b>6</b>	Auto and travel (see instructions) . . . . .	<b>6</b>		
<b>7</b>	Cleaning and maintenance . . . . .	<b>7</b> 1,500	525	
<b>8</b>	Commissions. . . . .	<b>8</b> 1,200	420	
<b>9</b>	Insurance . . . . .	<b>9</b> 2,000	700	
<b>10</b>	Legal and other professional fees . . . . .	<b>10</b> 1,000	390	
<b>11</b>	Management fees . . . . .	<b>11</b>		
<b>12</b>	Mortgage interest paid to banks, etc. (see instructions)	<b>12</b> 9,000	8,510	
<b>13</b>	Other interest. . . . .	<b>13</b>		
<b>14</b>	Repairs. . . . .	<b>14</b> 700	245	
<b>15</b>	Supplies . . . . .	<b>15</b> 600	210	
<b>16</b>	Taxes . . . . .	<b>16</b> 2,000	700	
<b>17</b>	Utilities . . . . .	<b>17</b> 2,400	840	
<b>18</b>	Depreciation expense or depletion . . . . .	<b>18</b> 10,000	4,000	
<b>19</b>	Other (list) ▶ <u>Wages and salaries</u>	<b>19</b> 9,000	3,150	
<b>20</b>	Total expenses. Add lines 5 through 19 . . . . .	<b>20</b> 40,000	19,900	
<b>21</b>	Subtract line 20 from line 4. If result is a (loss), see instructions to find out if you must file Form 6198 . . . . .	<b>21</b> (15,000)	(11,600)	
<b>22</b>	Deductible rental real estate loss after limitation, if any, on Form 8582 (see instructions) . . . . .	<b>22</b> ( 6,155 )	( 3,546 )	( )
<b>23a</b>	Total of all amounts reported on line 3a for all rental properties . . . . .	<b>23a</b>		
<b>b</b>	Total of all amounts reported on line 3a for all royalty properties . . . . .	<b>23b</b>		
<b>c</b>	Total of all amounts reported on line 4 for all rental properties . . . . .	<b>23c</b> 33,300		
<b>d</b>	Total of all amounts reported on line 4 for all royalty properties . . . . .	<b>23d</b>		
<b>e</b>	Total of all amounts reported on line 12 for all properties . . . . .	<b>23e</b> 17,510		
<b>f</b>	Total of all amounts reported on line 18 for all properties . . . . .	<b>23f</b> 14,000		
<b>g</b>	Total of all amounts reported on line 20 for all properties . . . . .	<b>23g</b> 59,900		
<b>24</b>	<b>Income.</b> Add positive amounts shown on line 21. <b>Do not</b> include any losses . . . . .	<b>24</b>		
<b>25</b>	<b>Losses.</b> Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here . . . . .	<b>25</b> ( 9,701 )		
<b>26</b>	<b>Total rental real estate and royalty income or (loss).</b> Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Form 1040, line 17, or Form 1040NR, line 18. Otherwise, include this amount in the total on line 41 on page 2 . . . . .	<b>26</b> (9,701)		

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 11344L

Schedule E (Form 1040) 2011



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

Charles and Lily Woods

Your social security number

123-00-4567

**Caution.** The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

**Part II Income or Loss From Partnerships and S Corporations** **Note.** If you report a loss from an at-risk activity for which any amount is not at risk, you must check the box in column (e) on line 28 and attach Form 6198. See instructions.

**27** Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section.  **Yes**  **No**

<b>28</b>	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if any amount is not at risk
<b>A</b>	Partnership #2 (EDPA)	P	<input type="checkbox"/>	10-1672810	<input type="checkbox"/>
<b>B</b>	Partnership #3 (EDPA)	P	<input type="checkbox"/>	10-9876243	<input type="checkbox"/>
<b>C</b>	Partnership #1	P	<input type="checkbox"/>	10-5566650	<input type="checkbox"/>
<b>D</b>	Partnership #4	P	<input type="checkbox"/>	10-7435837	<input type="checkbox"/>

<b>Passive Income and Loss</b>		<b>Nonpassive Income and Loss</b>		
(f) Passive loss allowed (attach Form 8582 if required)	(g) Passive income from Schedule K-1	(h) Nonpassive loss from Schedule K-1	(i) Section 179 expense deduction from Form 4562	(j) Nonpassive income from Schedule K-1
<b>A</b> From PTP(3,645)				
<b>B</b>		(9,000)		
<b>C</b> (2,600)	4,000			
<b>D</b> (148)				
<b>29a Totals</b>	4,000			
<b>b Totals</b> (6,393)		(9,000)		
<b>30</b> Add columns (g) and (j) of line 29a . . . . .				<b>30</b> 4,000
<b>31</b> Add columns (f), (h), and (i) of line 29b . . . . .				<b>31</b> ( 15,393 )
<b>32 Total partnership and S corporation income or (loss).</b> Combine lines 30 and 31. Enter the result here and include in the total on line 41 below . . . . .				<b>32</b> (11,393)

**Part III Income or Loss From Estates and Trusts**

<b>33</b>	(a) Name	(b) Employer identification number
<b>A</b>		
<b>B</b>		

<b>Passive Income and Loss</b>		<b>Nonpassive Income and Loss</b>	
(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
<b>A</b>			
<b>B</b>			
<b>34a Totals</b>			
<b>b Totals</b>			
<b>35</b> Add columns (d) and (f) of line 34a . . . . .			<b>35</b>
<b>36</b> Add columns (c) and (e) of line 34b . . . . .			<b>36</b> ( )
<b>37 Total estate and trust income or (loss).</b> Combine lines 35 and 36. Enter the result here and include in the total on line 41 below . . . . .			<b>37</b>

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

<b>38</b>	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b
<b>39</b>	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below				<b>39</b>

**Part V Summary**

<b>40</b>	Net farm rental income or (loss) from Form 4835. Also, complete line 42 below . . . . .	<b>40</b>	
<b>41</b>	<b>Total income or (loss).</b> Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Form 1040, line 17, or Form 1040NR, line 18 ▶	<b>41</b>	(21,094)
<b>42</b>	<b>Reconciliation of farming and fishing income.</b> Enter your gross farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120S), box 17, code U; and Schedule K-1 (Form 1041), line 14, code F (see instructions) . . . . .	<b>42</b>	
<b>43</b>	<b>Reconciliation for real estate professionals.</b> If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040 or Form 1040NR from all rental real estate activities in which you materially participated under the passive activity loss rules . . . . .	<b>43</b>	

**Sales of Business Property**  
**(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))**

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

Name(s) shown on return

Charles and Lily Woods

Identifying number

123-00-4567

**1** Enter the gross proceeds from sales or exchanges reported to you for 2011 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) . . . . .

**1**

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

<b>2</b>	<b>(a)</b> Description of property	<b>(b)</b> Date acquired (mo., day, yr.)	<b>(c)</b> Date sold (mo., day, yr.)	<b>(d)</b> Gross sales price	<b>(e)</b> Depreciation allowed or allowable since acquisition	<b>(f)</b> Cost or other basis, plus improvements and expense of sale	<b>(g)</b> Gain or (loss) Subtract (f) from the sum of (d) and (e)
	Section 1231 Assets	01-05-04	01-08-11	6,000		3,224	2,776
	Activity A						

**3** Gain, if any, from Form 4684, line 39 . . . . . **3**

**4** Section 1231 gain from installment sales from Form 6252, line 26 or 37 . . . . . **4**

**5** Section 1231 gain or (loss) from like-kind exchanges from Form 8824 . . . . . **5**

**6** Gain, if any, from line 32, from other than casualty or theft. . . . . **6**

**7** Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows: . . . . . **7** 2,776

**Partnerships (except electing large partnerships) and S corporations.** Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.

**Individuals, partners, S corporation shareholders, and all others.** If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.

**8** Nonrecaptured net section 1231 losses from prior years (see instructions) . . . . . **8**

**9** Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return (see instructions) . . . . . **9**

**Part II Ordinary Gains and Losses** (see instructions)

**10** Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):


**11** Loss, if any, from line 7 . . . . . **11** ( )

**12** Gain, if any, from line 7 or amount from line 8, if applicable . . . . . **12**

**13** Gain, if any, from line 31 . . . . . **13**

**14** Net gain or (loss) from Form 4684, lines 31 and 38a . . . . . **14**

**15** Ordinary gain from installment sales from Form 6252, line 25 or 36 . . . . . **15**

**16** Ordinary gain or (loss) from like-kind exchanges from Form 8824. . . . . **16**

**17** Combine lines 10 through 16 . . . . . **17**

**18** For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below:

**a** If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 28, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 23. Identify as from "Form 4797, line 18a." See instructions . . . . . **18a**

**b** Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Form 1040, line 14 . . . . . **18b**

## Passive Activity Loss Limitations

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

Name(s) shown on return  
*Charles and Lily Woods*

Identifying number  
 123-00-4567

**Part I 2011 Passive Activity Loss**

**Caution:** Complete Worksheets 1, 2, and 3 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** in the instructions.)

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

**Commercial Revitalization Deductions From Rental Real Estate Activities**

<b>2a</b> Commercial revitalization deductions from Worksheet 2, column (a) . . . . .	<b>2a</b>				
<b>b</b> Prior year unallowed commercial revitalization deductions from Worksheet 2, column (b) . . . . .	<b>2b</b>	( )			
<b>c</b> Add lines 2a and 2b . . . . .	<b>2c</b>			( )	

**All Other Passive Activities**

<b>3a</b> Activities with net income (enter the amount from Worksheet 3, column (a)) . . . . .	<b>3a</b>	4,000			
<b>b</b> Activities with net loss (enter the amount from Worksheet 3, column (b)) . . . . .	<b>3b</b>	( 2,400 )			
<b>c</b> Prior years unallowed losses (enter the amount from Worksheet 3, column (c)) . . . . .	<b>3c</b>	( 4,100 )			
<b>d</b> Combine lines 3a, 3b, and 3c . . . . .	<b>3d</b>			(2,500)	

<b>4</b> Combine lines 1d, 2c, and 3d. If this line is zero or more, stop here and include this form with your return; all losses are allowed, including any prior year unallowed losses entered on line 1c, 2b, or 3c. Report the losses on the forms and schedules normally used . . . . .	<b>4</b>			(41,216)	
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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 instructions for an example.

<b>5</b> Enter the <b>smaller</b> of the loss on line 1d or the loss on line 4 . . . . .	<b>5</b>	38,716			
<b>6</b> Enter \$150,000. If married filing separately, see instructions . . . . .	<b>6</b>	150,000			
<b>7</b> Enter modified adjusted gross income, but not less than zero (see instructions) . . . . .	<b>7</b>	138,655			
<b>Note:</b> 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.					
<b>8</b> Subtract line 7 from line 6 . . . . .	<b>8</b>	11,345			
<b>9</b> Multiply line 8 by 50% (.5). <b>Do not</b> enter more than \$25,000. If married filing separately, see instructions . . . . .	<b>9</b>	5,673			
<b>10</b> Enter the <b>smaller</b> of line 5 or line 9 . . . . .	<b>10</b>	5,673			

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 in the instructions.

<b>11</b> Enter \$25,000 reduced by the amount, if any, on line 10. If married filing separately, see instructions . . . . .	<b>11</b>				
<b>12</b> Enter the loss from line 4 . . . . .	<b>12</b>				
<b>13</b> Reduce line 12 by the amount on line 10 . . . . .	<b>13</b>				
<b>14</b> Enter the <b>smallest</b> of line 2c (treated as a positive amount), line 11, or line 13 . . . . .	<b>14</b>				

**Part IV Total Losses Allowed**

<b>15</b> Add the income, if any, on lines 1a and 3a and enter the total . . . . .	<b>15</b>	6,776			
<b>16</b> <b>Total losses allowed from all passive activities for 2011.</b> Add lines 10, 14, and 15. See instructions to find out how to report the losses on your tax return . . . . .	<b>16</b>			12,449	

**For Paperwork Reduction Act Notice, see instructions.**

Cat. No. 63704F

Form **8582** (2011)

**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 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
Activity A	2,776	(15,000)	(6,667)		(18,891)
Activity B		(11,600)	(8,225)		(19,825)
<b>Total. Enter on Form 8582, lines 1a, 1b, and 1c</b> . . . . . ▶	2,776	(26,600)	(14,892)		

**Worksheet 2 – For Form 8582, Lines 2a and 2b** (See instructions.)

Name of activity	(a) Current year deductions (line 2a)	(b) Prior year unallowed deductions (line 2b)	(c) Overall loss
<b>Total. Enter on Form 8582, lines 2a and 2b</b> . . . . . ▶			

**Worksheet 3 – For Form 8582, Lines 3a, 3b, and 3c** (See 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
Partnership #1	4,000		(2,600)	1,400	
Partnership #4		(2,400)	(1,500)		(3,900)
<b>Total. Enter on Form 8582, lines 3a, 3b, and 3c</b> . . . . . ▶	4,000	(2,400)	(4,100)		

**Worksheet 4 – Use this worksheet if an amount is shown on Form 8582, line 10 or 14** (See 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)
Activity A	Sch E, line 22	18,891	.487938	2,768	16,123
Activity B	Sch E, line 22	19,825	.512062	2,905	16,920
<b>Total</b> . . . . . ▶		38,716	1.00	5,673	33,043

**Worksheet 5 – Allocation of Unallowed Losses** (See instructions.)

Name of activity	Form or schedule and line number to be reported on (see instructions)	(a) Loss	(b) Ratio	(c) Unallowed loss
Activity A	Sch E, line 22	16,123	.436429	15,512
Activity B	Sch E, line 22	16,920	.458003	16,279
Partnership #4	Sch E, line 28D	3,900	.105568	3,752
<b>Total</b> . . . . . ▶		36,943	1.00	35,543



**Worksheet 6 – Allowed Losses** (See instructions.)

Name of activity	Form or schedule and line number to be reported on (see instructions)	(a) Loss	(b) Unallowed loss	(c) Allowed loss
Activity A	Sch E, line 22	21,667	15,512	6,155
Activity B	Sch E, line 22	19,825	16,279	3,546
Partnership #4	Sch E, line 28D	3,900	3,752	148
<b>Total</b> . . . . . ▶		45,392	35,543	9,849

**Worksheet 7 – Activities With Losses Reported on Two or More Forms or Schedules** (See instructions.)

Name of activity:	(a)	(b)	(c) Ratio	(d) Unallowed loss	(e) Allowed loss
<b>Form or schedule and line number to be reported on (see instructions):</b>					
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- ▶					
<b>Form or schedule and line number to be reported on (see instructions):</b>					
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- ▶					
<b>Form or schedule and line number to be reported on (see instructions):</b>					
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- ▶					
<b>Total</b> . . . . . ▶			1.00		

## At-Risk Limits

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



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

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

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

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

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

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

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

## Who Is Affected?

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

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

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

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

## Activities Covered by the At-Risk Rules

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

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

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

1. Personal property,
2. Other tangible property (other than a building or its structural components) that is:
  - a. Used in manufacturing, production, extraction or furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services,

- b. A research facility used for the activities in (a), or
  - c. A facility used in any of the activities in (a) for the bulk storage of fungible commodities,
3. Real property (other than property described in (2)) with an adjusted basis that was reduced by certain amortization deductions listed in section 1245(a)(3)(C) of the Internal Revenue Code,
  4. A single purpose agricultural or horticultural structure, or
  5. A storage facility (other than a building or its structural components) used for the distribution of petroleum.

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

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

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

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

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

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

**Special exception for qualified corporations.** A qualified corporation is not subject to the at-risk limits for any qualifying business carried

on by the corporation. Each qualifying business is treated as a separate activity.

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

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

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

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

## Separation of Activities

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

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

## Aggregation of Activities

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

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

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

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

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

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

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

## At-Risk Amounts

You are at risk in any activity for:

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

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

security if it is directly or indirectly financed by debt that is secured by property you contributed to the activity.



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

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

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

**Related persons.** Related persons include:

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

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

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

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

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

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

## Amounts Not At Risk

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

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

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

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

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

### **Other types of property used as security.**

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

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

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

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

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

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

- A person who receives a fee due to your investment in the real property or a person related to that person.

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

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

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

## Reductions of Amounts At Risk

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

## Recapture Rule

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

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

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

**Pre-1979 activity.** If the amount you had at risk in an activity at the end of your tax year that began in 1978 was less than zero, you apply the



preceding rule for the recapture of losses by substituting that negative amount for zero. For example, if your at-risk amount for that tax year was minus \$50, you will recapture losses only when your at-risk amount goes below minus \$50.

## How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

**Free help with your return.** Free help in preparing your return is available nationwide from IRS-certified volunteers. The Volunteer Income Tax Assistance (VITA) program is designed to help low-moderate income taxpayers and the Tax Counseling for the Elderly (TCE) program is designed to assist taxpayers age 60 and older with their tax returns. Most VITA and TCE sites offer free electronic filing and all volunteers will let you know about credits and deductions you may be entitled to claim. To find the nearest VITA or TCE site, visit [IRS.gov](http://IRS.gov) or call 1-800-906-9887 or 1-800-829-1040.

As part of the TCE program, AARP offers the Tax-Aide counseling program. To find the nearest AARP Tax-Aide site, call 1-888-227-7669 or visit AARP's website at [www.aarp.org/money/taxaide](http://www.aarp.org/money/taxaide).

For more information on these programs, go to [IRS.gov](http://IRS.gov) and enter keyword "VITA" in the upper right-hand corner.



**Internet.** You can access the IRS website at [IRS.gov](http://IRS.gov) 24 hours a day, 7 days a week to:

- Check the status of your 2011 refund. Go to [IRS.gov](http://IRS.gov) and click on *Where's My Refund*. Wait at least 72 hours after the IRS acknowledges receipt of your e-filed return, or 3 to 4 weeks after mailing a paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2011 tax return available so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund.
- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Download forms, including talking tax forms, instructions, and publications.
- Order IRS products online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- Use the online Internal Revenue Code, regulations, or other official guidance.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using the withholding calculator online at [www.irs.gov/individuals](http://www.irs.gov/individuals).

- Determine if Form 6251 must be filed by using our Alternative Minimum Tax (AMT) Assistant available online at [www.irs.gov/individuals](http://www.irs.gov/individuals).
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.



**Phone.** Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call 1-800-TAX-FORM (1-800-829-3676) to order current-year forms, instructions, and publications, and prior-year forms and instructions. You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to [www.irs.gov/localcontacts](http://www.irs.gov/localcontacts) or look in the phone book under *United States Government, Internal Revenue Service*.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* You can check the status of your refund on the new IRS phone app. Download the free IRS2Go app by visiting the iTunes app store or the Android Marketplace. IRS2Go is a new way to provide you with information and tools. To check the status of your refund by phone, call 1-800-829-4477 (automated refund information 24 hours a day, 7 days a week). Wait at least 72 hours after the IRS acknowledges receipt of your e-filed return, or 3 to 4 weeks after mailing a paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2011 tax return available so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund. If you check the status of your refund and are not given the date it will be issued, please wait until the next week before checking back.
- *Other refund information.* To check the status of a prior-year refund or amended return refund, call 1-800-829-1040.

**Evaluating the quality of our telephone services.** To ensure IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality

of our telephone services. One method is for a second IRS representative to listen in on or record random telephone calls. Another is to ask some callers to complete a short survey at the end of the call.



**Walk-in.** Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- *Services.* You can walk in to your local Taxpayer Assistance Center every business day for personal, face-to-face tax help. An employee can explain IRS letters, request adjustments to your tax account, or help you set up a payment plan. If you need to resolve a tax problem, have questions about how the tax law applies to your individual tax return, or you are more comfortable talking with someone in person, visit your local Taxpayer Assistance Center where you can spread out your records and talk with an IRS representative face-to-face. No appointment is necessary—just walk in. If you prefer, you can call your local Center and leave a message requesting an appointment to resolve a tax account issue. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. If you have an ongoing, complex tax account problem or a special need, such as a disability, an appointment can be requested. All other issues will be handled without an appointment. To find the number of your local office, go to [www.irs.gov/localcontacts](http://www.irs.gov/localcontacts) or look in the phone book under *United States Government, Internal Revenue Service*.



**Mail.** You can send your order for forms, instructions, and publications to the address below. You should receive a response within 10 days after your request is received.

Internal Revenue Service  
1201 N. Mitsubishi Motorway  
Bloomington, IL 61705-6613

**Taxpayer Advocate Service.** The Taxpayer Advocate Service (TAS) is your voice at the IRS. Our job is to ensure that every taxpayer is treated fairly, and that you know and understand your rights. We offer free help to guide you through the often-confusing process of resolving tax problems that you haven't been able to solve on your own. Remember, the worst thing you can do is nothing at all.

TAS can help if you can't resolve your problem with the IRS and:

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

If you qualify for our help, we'll do everything we can to get your problem resolved. You will be assigned to one advocate who will be with you at every turn. We have offices in every state, the District of Columbia, and Puerto Rico. Although TAS is independent within the IRS, our advocates know how to work with the IRS to get your problems resolved. And our services are always free.

As a taxpayer, you have rights that the IRS must abide by in its dealings with you. Our tax toolkit at [www.TaxpayerAdvocate.irs.gov](http://www.TaxpayerAdvocate.irs.gov) can help you understand these rights.

If you think TAS might be able to help you, call your local advocate, whose number is in your phone book and on our website at [www.irs.gov/advocate](http://www.irs.gov/advocate). You can also call our toll-free number at 1-877-777-4778.

TAS also handles large-scale or systemic problems that affect many taxpayers. If you know of one of these broad issues, please report it to us through our Systemic Advocacy Management System at [www.irs.gov/advocate](http://www.irs.gov/advocate).

**Low Income Taxpayer Clinics (LITCs).** Low Income Taxpayer Clinics (LITCs) are independent from the IRS. Some clinics serve individuals whose income is below a certain level

and who need to resolve a tax problem. These clinics provide professional representation before the IRS or in court on audits, appeals, tax collection disputes, and other issues for free or for a small fee. Some clinics can provide information about taxpayer rights and responsibilities in many different languages for individuals who speak English as a second language. For more information and to find a clinic near you, see the LITC page on [www.irs.gov/advocate](http://www.irs.gov/advocate) or IRS Publication 4134, *Low Income Taxpayer Clinic List*. This publication is also available by calling 1-800-829-3676 or at your local IRS office.

**Free tax services.** Publication 910, IRS Guide to Free Tax Services, is your guide to IRS services and resources. Learn about free tax information from the IRS, including publications, services, and education and assistance programs. The publication also has an index of over 100 TeleTax topics (recorded tax information) you can listen to on the telephone. The majority of the information and services listed in this publication are available to you free of charge. If there is a fee associated with a resource or service, it is listed in the publication.

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- Current-year forms, instructions, and publications.

- Prior-year forms, instructions, and publications.
- Tax Map: an electronic research tool and finding aid.
- Tax law frequently asked questions.
- Tax Topics from the IRS telephone response system.
- Internal Revenue Code—Title 26 of the U.S. Code.
- Links to other Internet based Tax Research Materials.
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- Two releases during the year.
  - The first release will ship the beginning of January 2012.
  - The final release will ship the beginning of March 2012.

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