[T.D. 8417, 57 FR 20748, May 15, 1992, as amended by T.D. 8477, 58 FR 11538, Feb. 26, 1993; T.D. 8495, 58 FR 58787, Nov. 4, 1993; T.D. 8565, 59 FR 50487, Oct. 4, 1994; T.D. 8597, 60 FR 36684, July 18, 1995; T.D. 8645, 60 FR 66498, Dec. 22, 1995]

§ 1.469–1 General rules.

(a)–(c)(7) [Reserved]

(c)(8) *Consolidated groups.* Rules relating to the application of section 469 to consolidated groups are contained in paragraph (h) of this section.

(c)(9)–(d)(1) [Reserved]

(d)(2) *Coordination with sections 613A (d) and 1211.* A passive activity deduction that is not disallowed for the taxable year under section 469 and the regulations thereunder may nonetheless be disallowed for the taxable year under section 613A(d) or 1211. The following example illustrates the application of this paragraph (d)(2):

Example. In 1993, an individual derives $10,000 of ordinary income from passive activity X, no gains from the sale or exchange of capital assets or assets used in a trade or business, $12,000 of capital loss from passive activity Y, and no income, gain, deductions, or losses from any other passive activity. The capital loss from activity Y is a passive activity deduction (within the meaning of §1.469–2T(d)). Under section 469 and the regulations thereunder, the taxpayer is allowed $10,000 of the $12,000 passive activity deduction and has a $2,000 passive activity loss for the taxable year. Since the $10,000 passive activity deduction allowed under section 469 is a capital loss, such deduction is allowable for the taxable year only to the extent provided under section 1211. Therefore, the taxpayer is allowed $3,000 of the $10,000 capital loss under section 1211 and has a $7,000 capital loss carryover (within the meaning of section 1212(b)) to the succeeding taxable year.

(d)(3)–(e)(1) [Reserved]

(e)(2) *Trade or business activities. Trade or business activities* are activities that constitute trade or business activities within the meaning of §1.469–4(b)(1).

(e)(3)(i)–(e)(3)(ii) [Reserved]

(e)(3)(iii) *Average period of customer use*—(A) *In general.* For purposes of this paragraph (e)(3), the average period of customer use for property held in connection with an activity (the *activity's average period of customer use)* is the sum of the average use factors for each class of property held in connection with the activity.

(B) *Average use factor.* The average use factor for a class of property held in connection with an activity is the average period of customer use for that class of property multiplied by the fraction obtained by dividing—

(*1*) The activity's gross rental income attributable to that class of property; by

(*2*) The activity's gross rental income.

(C) *Average period of customer use for class of property.* In determining an activity's average period of customer use for a taxable year, the average period

of customer use for a class of property held in connection with an activity is determined by dividing—

(*1*) The aggregate number of days in all periods of customer use for property in the class (taking into account only periods that end during the taxable year or that include the last day of the taxable year); by

(*2*) The number of those periods of customer use.

(D) *Period of customer use*. Each period during which a customer has a continuous or recurring right to use an item of property held in connection with the activity (without regard to whether the customer uses the property for the entire period or whether the right to use the property is pursuant to a single agreement or to renewals thereof) is treated for purposes of this paragraph (e)(3)(iii) as a separate period of customer use. The duration of a period of customer use that includes the last day of a taxable year may be determined on the basis of reasonable estimates.

(E) *Class of property*. Taxpayers may organize property into classes for purposes of this paragraph (e)(3)(iii) using any method under which items of property for which the amount of the daily rent differs significantly are not included in the same class.

(F) *Gross rental income and daily rent*. In determining an activity's average period of customer use for a taxable year—

(*1*) The activity's gross rental income is the gross income from the activity for the taxable year taking into account only income that is attributable to amounts paid for the use of property;

(*2*) The activity's gross rental income attributable to a class of property is the gross income from the activity for the taxable year taking into account only income that is attributable to amounts paid for the use of property in that class; and

(*3*) The daily rent for items of property may be determined on any basis that reasonably reflects differences during the taxable year in the amounts ordinarily paid for one day's use of those items of property.

(e)(3)(iv)–(e)(3)(vi)(C) [Reserved]

(e)(3)(vi)(D) *Lodging rented for convenience of employer*. The provision of lodging to an employee or to an employee's spouse or dependents is treated as incidental to the activity (or activities) of the taxpayer in which the employee performs services if the lodging is furnished for the taxpayer's convenience (within the meaning of section 119).

(E) *Unadjusted basis*. For purposes of this paragraph (e)(3)(vi), the term *unadjusted basis* means adjusted basis determined without regard to any adjustment described in section 1016 that decreases basis.

(e)(3)(vii)–(e)(4)(iii) [Reserved]

(e)(4)(iv) *Definition of* ''*working interest*.'' For purposes of section 469 and the regulations thereunder, the term *working interest* means a working or operating mineral interest in any tract or parcel of land (within the meaning of §1.612–4(a)).

(e)(4)(v)–(f)(3) [Reserved]

(f)(4) *Carryover of disallowed deductions and credits*—

(i) *In general*. In the case of an activity of a taxpayer with respect to which any deductions or credits are disallowed for a taxable year under §1.469–1T (f)(2) or (f)(3) (the loss activity)—

(A) The disallowed deductions or credits is allocated among the taxpayer's activities for the succeeding taxable year in a manner that reasonably reflects the extent to which each activity continues the loss activity; and

(B) The disallowed deductions or credits allocated to an activity under paragraph (f)(4)(i)(A) of this section shall be treated as deductions or credits from the activity for the succeeding taxable year.

(ii) *Business continued through C corporations or similar entities*. If a taxpayer continues part or all of a loss activity through a C corporation or similar entity (C corporation entity), the taxpayer's interest in the C corporation entity shall be treated for purposes of this paragraph (f)(4) as an interest in a passive activity that continues that loss activity in whole or part. An entity is similar to a C corporation for this purpose if the owners of interests in the entity derive only portfolio income (within the meaning of §1.469–2T(c)(3)(i)) from the interests.

(iii) *Examples*. The following examples illustrate the application of this

paragraph (f)(4). In each example, the taxpayer is an individual whose taxable year is the calendar year.

Example 1. (i) The taxpayer owns interests in a convenience store and an apartment building. In each taxable year, the taxpayer's interests in the convenience store and the apartment building are treated under §1.469–4 as interests in two separate passive activities of the taxpayer. A $5,000 loss from the convenience-store activity and a $3,000 loss from the apartment-building activity are disallowed under §1.469–1T(f)(2) for 1993. Under §1.469–1T(f)(2), the $5,000 loss from the convenience-store activity is allocated among the passive activity deductions from that activity for 1993, and the $3,000 loss from the apartment-building activity is treated similarly.

(ii) In 1994, the convenience store is continued in a single activity, and the section 469 activities that constituted the apartment building is similarly continued in a separate activity. Thus, the disallowed deductions from the convenience-store activity for 1993 must be allocated under paragraph (f)(4)(i)(A) of this section to the taxpayer's convenience-store activity in 1994. Similarly, the disallowed deductions from the apartment-building activity for 1993 must be allocated to the taxpayer's apartment-building activity in 1994. Under paragraph (f)(4)(i)(B) of this section, the disallowed deductions allocated to the convenience-store activity in 1994 are treated as deductions from that activity for 1994, and the disallowed deductions allocated to the apartment-building activity for 1994 are treated as deductions from the apartment-building activity for 1994.

Example 2. (i) In 1993, the taxpayer acquires a restaurant and a catering business. Assume that in 1993 and 1994 the restaurant and the catering business are treated under §1.469–4 as an interest in a single passive activity of the taxpayer (the restaurant and catering activity). A $10,000 loss from the activity is disallowed under §1.469–1T(f)(2) for 1994. Assume that in 1995, the taxpayer's interests in the restaurant and the catering business are treated under §1.469–4 as interests in two separate passive activities of the taxpayer.

(ii) Under §1.469–1T(f)(2), the $10,000 loss from the restaurant and catering activity is allocated among the passive activity deductions from that activity for 1994. In 1995, the businesses that constituted the restaurant and catering activity are continued, but are treated as two separate activities under §1.469–4. Thus, the disallowed deductions from the restaurant and catering activity for 1994 must be allocated under paragraph (f)(4)(i)(A) of this section between the restaurant activity and the catering activity in 1995 in a manner that reasonably reflects the extent to which each of the activities continues the single restaurant and catering activity. Under paragraph (f)(4)(i)(B) of this section, the disallowed deductions allocated to the restaurant activity in 1995 are treated as deductions from the restaurant activity for 1995, and the disallowed deductions allocated to the catering activity in 1995 are treated as deductions from the catering activity for 1995.

Example 3. (i) In 1993, the taxpayer acquires a restaurant and a catering business. Assume that in 1993 and 1994 the restaurant and the catering business are treated under§1.469–4 as an interest in a single passive activity of the taxpayer (the restaurant and catering activity). A $10,000 loss from the activity is disallowed under §1.469–1T(f)(2) for 1994. Assume that in 1995, the taxpayer's interests in the restaurant and the catering business are treated under §1.469–4 as interestes in two separate passive activities of the taxpayer. In addition, a $20,000 loss from the activity was disallowed under §1.469–1T(f)(2) for 1993, and the gross income and deductions (including deductions that were disallowed for 1993 under §1.469–1T(f)(2)) from the restaurant and catering business for 1993 and 1994 are as follows:

	Restaurant	Catering business
1993:		
Gross income	$20,000	$60,000
Deductions	40,000	60,000
Net income (loss)	(20,000)	
1994:		
Gross income	40,000	50,000
Deductions	[1] 30,000	[2] 70,000
Net income (loss)	10,000	(20,000)

[1] Includes $8,000 of deductions that were disallowed for 1993 ($20,000 × $40,000/$100,000).
[2] Includes $12,000 of deductions that were disallowed for 1993 ($20,000 × $60,000/$100,000).

(ii) Under paragraph (f)(4)(i)(A) of this section, the disallowed deductions from the restaurant and catering activity must be allocated among the taxpayer's activities for the succeeding year in a manner that reasonably reflects the extent to which those activities continue the restaurant and catering activity. The remainder of this example describes a number of allocation methods that will ordinarily satisfy the requirement of paragraph (f)(4)(i)(A) of this section. The description of specific allocation methods in this example does not preclude the use of other reasonable allocation methods for purposes of paragraph (f)(4)(i)(A) of this section.

(iii) Ordinarily, an allocation of disallowed deductions from the restaurant to the restaurant activity and disallowed deductions from the catering business to the catering activity would satisfy the requirement of paragraph (f)(4)(i)(A) of this section. Under §1.469–1T (f)(2)(ii), a ratable portion of each deduction from the restaurant and catering activity is disallowed for 1994. Thus, $3,000 of

the 1994 deductions from the restaurant are disallowed ($10,000 × $30,000/$100,000), and $7,000 of the 1994 deductions from the catering business are disallowed ($10,000 × $70,000/$100,000). Thus, the taxpayer can ordinarily treat $3,000 of the disallowed deductions as deductions from the restaurant activity for 1995, and $7,000 of the disallowed deductions as deductions from the catering activity for 1995.

(iv) Ordinarily, an allocation of disallowed deductions between the restaurant activity and catering activity in proportion to the losses from the restaurant and from the catering business for 1994 would also satisfy the requirement of paragraph (f)(4)(i)(A) of this section. If the restaurant and the catering business had been treated as separate activities in 1994, the restaurant activity would have had net income of $10,000 and the catering activity would have had a $20,000 loss. Thus, the taxpayer can ordinarily treat all $10,000 of disallowed deductions as deductions from the catering activity for 1995.

(v) Ordinarily, an allocation of disallowed deductions between the restaurant activity and catering activity in proportion to the losses from the restaurant and from the catering business for 1994 (determined as if the restaurant and the catering business had been separate activities for all taxable years) would also satisfy the requirement of paragraph (f)(4)(i)(A) of this section. If the restaurant and the catering business had been treated as separate activities for all taxable years, the entire $20,000 loss from the restaurant in 1993 would have been allocated to the restaurant activity in 1994, and the gross income and deductions from the separate activities for 1994 would be as follows:

	Restaurant	Catering business
Gross income	$40,000	$50,000
Deductions	42,000	58,000
Net income (loss)	(2,000)	(8,000)

Thus, the taxpayer can ordinarily treat $2,000 of the disallowed deductions as deductions from the restaurant activity for 1995, and $8,000 of the disallowed deductions as deductions from the catering activity for 1995.

Example 4. (i) The taxpayer is a partner in a law partnership that acquires a building in December 1993 for use in the partnership's law practice. In taxable year 1993, four floors that are not needed in the law practice are leased to tenants; in taxable year 1994, two floors are leased to tenants; in taxable years after 1994, only one floor is leased to tenants and the rental operations are insubstantial. Assume that under §1.469–4, the law practice and the rental property are treated as a trade or business activity and a separate rental activity for taxable years 1993 and 1994. Assume further that the law practice and the rental operations are a single trade or business activity for taxable years after 1994 under §1.469–4. The trade or business activity is not a passive activity of the taxpayer. The rental activity, however, is a passive activity. Under §1.469–T(f)(2), a $12,000 loss from the rental activity is disallowed for 1993 and a $9,000 loss from the rental activity is disallowed for 1994.

(ii) Under §1.469–1T(f)(2), the $12,000 loss from the rental activity for 1993 is allocated among the passive activity deductions from that activity for 1993. In 1994, the business of the rental activity is continued in two separate activities. Only two floors of the building remain in the rental activity, and the other two floors (*i.e.*, the floors that were leased to tenants in 1993, but not in 1994) are used in the taxpayer's law-practice activity. Thus, the disallowed deductions from the rental activity for 1993 must be allocated under paragraph (f)(4)(i)(A) of this section between the rental activity and the law-practice activity in a manner that reasonably reflects the extent to which each of the activities continues business on the four floors that were leased to tenants in 1993. In these circumstances, the requirement of paragraph (f)(4)(i)(A) of this section would ordinarily be satisfied by any of the allocation methods illustrated in Example 3 or by an allocation of 50 percent of the disallowed deductions to each activity. Under paragraph (f)(4)(i)(B) of this section, the disallowed deductions allocated to the rental activity in 1994 are treated as deductions from the rental activity for 1994, and the disallowed deductions ($6,000) allocated to the law-practice activity in 1994 are treated as deductions from the law-practice activity for 1994.

(iii) Under §1.469–1T(f)(2), the $9,000 loss from the rental activity for 1994 is allocated among the passive activity deductions from that activity for 1994. In 1995, the rental activity is continued in the taxpayer's law-practice activity. Thus, the disallowed deductions from the rental activity for 1994 must be allocated under paragraph (f)(4)(ii) of this section to the taxpayer's law-practice activity in 1995. Under paragraph (f)(4)(i)(B) of this section, the disallowed deductions allocated to the law-practice activity are treated as deductions from the law-practice activity for 1995.

(iv) Rules relating to former passive activities will be contained in paragraph (k) of this section. Under those rules, any disallowed deductions from the rental activity that are treated as deductions from the law-practice activity will be treated as unused deductions that are allocable to a former passive activity.

Example 5. (i) The taxpayer owns stock in a corporation that is an S corporation for the taxpayer's 1993 taxable year and a C coporation thereafter. The only activity of the corporation is a rental activity. For 1993,

the taxpayer's pro rata share of the corporation's loss from the rental activity is $5,000, and the entire loss is disallowed under §1.469–1T(f)(2) of this section.

(ii) Under §1.469–1T(f)(2), the taxpayer's $5,000 loss from the rental activity is allocated among the taxpayer's deductions from that activity for 1993. In 1994, the rental activity is continued through a C corporation, and the taxpayer's interest in the C corporation is treated under paragraph (f)(4)(ii) of this section as a passive activity that continues the rental activity (the C corporation activity) for purposes of allocating the previously disallowed loss. Thus, the disallowed deductions from the rental activity for 1993 must be allocated under paragraph (f)(4)(i)(A) of this section to the taxpayer's C corporation activity in 1994, and are treated under paragraph (f)(4)(i)(B) of this section as deductions from the C corporation activity for 1994.

(iii) Treating the taxpayer's interest in the C corporation as an interest in a passive activity that continues the business of the rental activity does not change the character of the taxpayer's dividend income from the C corporation. Thus, the taxpayer's dividend income is portfolio income (within the meaning of §1.469–2T(c)(3)(i)) and is not included in passive activity gross income. Accordingly, the taxpayer's loss from the C corporation activity for 1994 is $5,000.

Example 6. (i) The taxpayer owns stock in a corporation that is an S corporation for the taxpayer's 1993 taxable year and a C corporation thereafter. The only activity of the corporation is a rental activity. For 1993, the taxpayer's pro rata share of the corporation's loss from the rental activity is $5,000, and the entire loss is disallowed under §1.469–1T(f)(2). The taxpayer has $2,000 in income from other passive activities for 1994, and as a result, only 60% of the taxpayer's loss from the C corporation activity ($3,000) is disallowed for 1994 under §1.469–1T(f)(2).

(ii) Under §1.469–1T(f)(2), the $3,000 disallowed loss from the C corporation activity is allocated among the passive activity deductions from that activity for 1994. In effect, therefore, 60 percent of each disallowed deduction from the rental activity for 1993 is again disallowed for 1994.

(iii) Under paragraph (f)(4) of this section, the taxpayer's interest in the C corporation is treated as a loss activity and as an interest in a passive activity that continues the business of that loss activity for 1995. Thus, the disallowed deductions from the C corporation activity for 1994 must be allocated under paragraph (f)(4)(i)(A) of this section to the taxpayer's C corporation activity in 1995, and are treated under paragraph (f)(4)(i)(B) of this section as deductions from that activity for 1995.

(g)(1)–(g)(4)(ii)(B) [Reserved]

(g)(4)(ii)(C) Portfolio income (within the meaning of §1.469–2T(c)(3)(i)), including any gross income that is treated as portfolio income under any other provision of the regulations (See, e.g., §1.469–2(c)(2)(iii)(F) (relating to gain from the disposition of substantially appreciated property formerly held for investment) and §1.469–2(f)(10) (relating to certain recharacterized passive activity gross income))

(5) [Reserved]

(h)(1) *In general.* This paragraph (h) provides rules for applying section 469 in computing a consolidated group's consolidated taxable income and consolidated tax liability (and the separate taxable income and tax liability of each member).

(2) *Definitions.* The definitions and nomenclature in the regulations under section 1502 apply for purposes of this paragraph (h). See, e.g., §§1.1502–1 (definitions of group, consolidated group, member, subsidiary, and consolidated return year), 1.1502–2 (consolidated tax liability), 1.1502–11 (consolidated taxable income), 1.1502–12 (separate taxable income), 1.1502–13 (intercompany transactions), 1.1502–21 (net operating losses, and 1.1502–22 (consolidated net capital gain and loss).

(3) [Reserved]

(4) *Status and participation of members*—(i) *Determination by reference to status and participation of group.* For purposes of section 469 and the regulations thereunder—

(A) Each member of a consolidated group shall be treated as a closely held corporation or personal service corporation, respectively, for the taxable year, if and only if the consolidated group is treated (under the rules of paragraph (h)(4)(ii) of this section) as a closely held corporation or personal service corporation for that year; and

(B) The determination of whether a trade or business activity (within the meaning of paragraph (e)(2) of this section) conducted by one or more members of a consolidated group is a passive activity of the members is made by reference to the consolidated group's participation in the activity.

(ii) *Determination of status and participation of consolidated group.* For purposes of determining under §1.469–1T(g)(2) whether a consolidated group

is treated as a closely held corporation or a personal service corporation, and determining under §1.469–1T(g)(3) whether the consolidated group materially or significantly participates in any activity conducted by one or more members of the group—

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

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

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

(D) An activity is treated as the principal activity of the corporation if and only if it is the principal activity (within the meaning of §1.441–4T(f)) of the consolidated group.

(5) [Reserved]

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

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

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

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

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

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

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

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

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

(h)(7)–(k) [Reserved]

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§ 1.469–1T General rules (temporary).

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

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

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

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

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