

having used the property in all of the activities in which the group has used such property

(i) [Reserved]

(j) *Spouses filing joint return*—(1) *In general.* Except as otherwise provided in the regulations under section 469, spouses filing a joint return for a taxable year shall be treated for such year as one taxpayer for purposes of section 469 and the regulations thereunder. Thus, for example, spouses filing a joint return are treated as one taxpayer for purposes of—

(i) Section 1.469-2T (relating generally to the computation of such taxpayer's passive activity loss); and

(ii) Paragraph (f) of this section (relating to the allocation of such taxpayer's disallowed passive activity loss and passive activity credit among activities and the identification of disallowed passive activity deductions and credits from passive activities).

(2) *Exceptions to treatment as one taxpayer*—(i) *Identification of disallowed deductions and credits.* For purposes of paragraphs (f)(2)(iii) and (3)(iii) of this section, spouses filing a joint return for the taxable year must account separately for the deductions and credits attributable to the interests of each spouse in any activity.

(ii) *Treatment of deductions disallowed under sections 704(d), 1366(d), and 465.* Notwithstanding any other provision of this section or § 1.469-2T, this paragraph (j) shall not affect the application of section 704(d), section 1366(d), or section 465 to taxpayers filing a joint return for the taxable year.

(iii) *Treatment of losses from working interests.* Paragraph (e)(4) of this section (relating to losses and credits from certain interests in oil and gas wells) shall be applied by treating a husband and wife (whether or not filing a joint return) as separate taxpayers.

(3) *Joint return no longer filed.* If an individual—

(A) Does not file a joint return for the taxable years; and

(B) Filed a joint return for the immediately preceding taxable year;

then the passive activity deductions and credits allocable to such individual's activities for the taxable year under paragraph (f)(4) of this section shall be determined by taking into ac-

count the items of deduction and credit attributable to such individual's interests in passive activities for the immediately preceding taxable year. See paragraph (j)(2)(i) of this section.

(4) *Participation of spouses.* Rules treating an individual's participation in an activity as participation of such individual's spouse in such activity (without regard to whether the spouses file a joint return) are contained in § 1.469-5T(f)(3).

(k) *Former passive activities and changes in status of corporations.* [Reserved]

[T.D. 8175, 53 FR 5700, Feb. 25, 1988, as amended by T.D. 8253, 54 FR 20535, May 12, 1989; T.D. 8319, 55 FR 49038, Nov. 26, 1990; T.D. 8417, 57 FR 20753, May 15, 1992; 58 FR 29536, May 21, 1993; 58 FR 45059, Aug. 26, 1993; 59 FR 17478, Apr. 13, 1994; T.D. 8560, 59 FR 41674, Aug. 15, 1994; T.D. 8597, 60 FR 36685, July 18, 1995]

**§ 1.469-2 Passive activity loss.**

(a)–(c)(2)(ii) [Reserved]

(c)(2)(iii) *Disposition of substantially appreciated property formerly used in nonpassive activity*—(A) *In general.* If an interest in property used in an activity is substantially appreciated at the time of its disposition, any gain from the disposition shall be treated as not from a passive activity unless the interest in property was used in a passive activity for either—

(1) 20 percent of the period during which the taxpayer held the interest in property; or

(2) The entire 24-month period ending on the date of the disposition.

(B) *Date of disposition.* For purposes of this paragraph (c)(2)(iii), a disposition of an interest in property is deemed to occur on the date that the interest in property becomes subject to an oral or written agreement that either requires the owner or gives the owner an option to transfer the interest in property for consideration that is fixed or otherwise determinable on that date.

(C) *Substantially appreciated property.* For purposes of this paragraph (c)(2)(iii), an interest in property is substantially appreciated if the fair market value of the interest in property exceeds 120 percent of the adjusted basis of the interest.

(D) *Investment property.* For purposes of this paragraph (c)(2)(iii), an interest

in property is treated as an interest in property used in an activity other than a passive activity and as an interest in property held for investment for any period during which the interest is held through a C corporation or similar entity. 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) from the interests.

(E) *Coordination with § 1.469-2T(c)(2)(ii).* If § 1.469-2T(c)(2)(ii) applies to the disposition of an interest in property, this paragraph (c)(2)(iii) applies only to that portion of the gain from the disposition of the interest in property that is characterized as gain from a passive activity after the application of § 1.469-2T(c)(2)(ii).

(F) *Coordination with section 163(d).* Gain that is treated as not from a passive activity under this paragraph (c)(2)(iii) is treated as income described in section 469(e)(1)(A) and § 1.469-2T(c)(3)(i) if and only if the gain is from the disposition of an interest in property that was held for investment for more than 50 percent of the period during which the taxpayer held that interest in property in activities other than passive activities.

(G) *Examples.* The following examples illustrate the application of this paragraph (c)(2)(iii):

*Example 1.* A acquires a building on January 1, 1993, and uses the building in a trade or business activity in which A materially participates until March 31, 2004. On April 1, 2004, A leases the building to B. On December 31, 2005, A sells the building. At the time of the sale, A's interest in the building is substantially appreciated (within the meaning of paragraph (c)(2)(iii)(C) of this section). Assuming A's lease of the building to B constitutes a rental activity (within the meaning of § 1.469-1T(e)(3)), the building is used in a passive activity for 21 months (April 1, 2004, through December 31, 2005). Thus, the building was not used in a passive activity for the entire 24-month period ending on the date of the sale. In addition, the 21-month period during which the building was used in a passive activity is less than 20 percent of A's holding period for the building (13 years). Therefore, the gain from the sale is treated under this paragraph (c)(2)(iii) as not from a passive activity.

*Example 2.* (i) A, an individual, is a stockholder of corporation X. X is a C corporation until December 31, 1993, and is an S corporation thereafter. X acquires a building on

January 1, 1993, and sells the building on March 1, 1994. At the time of the sale, A's interest in the building held through X is substantially appreciated (within the meaning of paragraph (c)(2)(iii)(C) of this section). The building is leased to various tenants at all times during the period in which it is held by X. Assume that the lease of the building would constitute a rental activity (within the meaning of § 1.469-1T(e)(3)) with respect to a person that holds the building directly or through an S corporation.

(ii) Paragraph (c)(2)(iii)(D) of this section provides that an interest in property is treated for purposes of this paragraph (c)(2)(iii) as used in an activity other than a passive activity and as held for investment for any period during which the interest is held through a C corporation. Thus, for purposes of determining the character of A's gain from the sale of the building, A's interest in the building is treated as an interest in property held for investment for the period from January 1, 1993, to December 31, 1993, and as an interest in property used in a passive activity for the period from January 1, 1994, to February 28, 1994.

(iii) A's interest in the building was not used in a passive activity for the entire 24-month period ending on the date of the sale. In addition, the 2-month period during which A's interest in the building was used in a passive activity is less than 20 percent of the period during which A held an interest in the building (14 months). Therefore, the gain from the sale is treated under this paragraph (c)(2)(iii) as not from a passive activity.

(iv) Under paragraph (c)(2)(iii)(F) of this section, gain that is treated as nonpassive under this paragraph (c)(2)(iii) is treated as portfolio income (within the meaning of § 1.469-2T(c)(3)(i)) if the gain is from the disposition of an interest in property that was held for investment for more than 50 percent of the period during which the taxpayer held the interest in activities other than passive activities. In this case, A's interest in the building was treated as held for investment for the entire period during which it was used in activities other than passive activities (i.e., the 12-month period from January 1, 1993, to December 31, 1993). Accordingly, A's gain from the sale is treated under this paragraph (c)(2)(iii) as portfolio income.

(iv) *Taxable acquisitions.* If a taxpayer acquires an interest in property in a transaction other than a nonrecognition transaction (within the meaning of section 7701(a)(45)), the ownership and use of the interest in property before the transaction is not taken into account for purposes of applying this paragraph (c)(2) to any subsequent disposition of the interest in property by the taxpayer.

(v) *Property held for sale to customers—*  
 (A) *Sale incidental to another activity—*  
 (1) *Applicability—(i) In general.* This paragraph (c)(2)(v)(A) applies to the disposition of a taxpayer's interest in property if and only if—

(A) At the time of the disposition, the taxpayer holds the interest in property in an activity that, for purposes of section 1221(1), involves holding the property or similar property primarily for sale to customers in the ordinary course of a trade or business (a dealing activity);

(B) One or more other activities of the taxpayer do not involve holding similar property for sale to customers in the ordinary course of a trade or business (nondealing activities) and the interest in property was used in the nondealing activity or activities for more than 80 percent of the period during which the taxpayer held the interest in property; and

(C) The interest in property was not acquired and held by the taxpayer for the principal purpose of selling the interest to customers in the ordinary course of a trade or business.

(ii) *Principal purpose.* For purposes of this paragraph (c)(2)(v)(A), a taxpayer is rebuttably presumed to have acquired and held an interest in property for the principal purpose of selling the interest to customers in the ordinary course of a trade or business if—

(A) The period during which the interest in property was used in nondealing activities of the taxpayer does not exceed the lesser of 24 months or 20 percent of the recovery period (within the meaning of section 168) applicable to the property; or

(B) The interest in property was simultaneously offered for sale to customers and used in a nondealing activity of the taxpayer for more than 25 percent of the period during which the interest in property was used in nondealing activities of the taxpayer.

For purposes of the preceding sentence, an interest in property is not considered to be offered for sale to customers solely because a lessee of the property has been granted an option to purchase the property.

(2) *Dealing activity not taken into account.* If paragraph (c)(2)(v)(A) applies to the disposition of a taxpayer's inter-

est in property, holding the interest in the dealing activity is treated, for purposes of § 1.469-2T(c)(2), as the use of the interest in the last nondealing activity of the taxpayer in which the interest in property was used prior to its disposition.

(B) *Use in a nondealing activity incidental to sale.* If paragraph (c)(2)(v)(A) of this section does not apply to the disposition of a taxpayer's interest in property that is held in a dealing activity of the taxpayer at the time of disposition, the use of the interest in property in a nondealing activity of the taxpayer for any period during which the interest in property is also offered for sale to customers is treated, for purposes of § 1.469-2T(c)(2), as the use of the interest in property in the dealing activity of the taxpayer.

(C) *Examples.* The following examples illustrate the application of this paragraph (c)(2)(v):

*Example 1.* (i) The taxpayer acquires a residential apartment building on January 1, 1993, and uses the building in a rental activity. In January 1996, the taxpayer converts the apartments into condominium units. After the conversion, the taxpayer holds the condominium units for sale to customers in the ordinary course of a trade or business of dealing in condominium units. (Assume that these are dealing operations treated as separate activities under § 1.469-4, and that the taxpayer materially participates in the activity.) In addition, the taxpayer continues to use the units in the rental activity until they are sold. The units are first held for sale on January 1, 1996, and the last unit is sold on December 31, 1996.

(ii) This paragraph (c)(2)(v) provides that holding an interest in property in a dealing activity (the marketing of the property) is treated for purposes of § 1.469-2T(c)(2) as the use of the interest in a nondealing activity if the marketing of the property is incidental to the nondealing use. Under paragraph (c)(2)(v)(A)(2) of this section, the interests in property are treated as used in the last nondealing activity in which they were used prior to their disposition. In addition, paragraph (c)(2)(v)(A)(1) of this section provides rules for determining whether the marketing of the property is incidental to the use of an interest in property in a nondealing activity. Under these rules, the marketing of the property is treated as incidental to the use in a nondealing activity if the interest in property was used in nondealing activities for more than 80 percent of the taxpayer's holding period in the property (the holding period requirement) and the taxpayer did not

acquire and hold the interest in property for the principal purpose of selling it to customers in the ordinary course of a trade or business (a dealing purpose).

(iii) In this case, the apartments were used in a rental activity for the entire period during which they were held by the taxpayer. Thus, the apartments were used in a nondealing activity for more than 80 percent of the taxpayer's holding period in the property, and the marketing of the property satisfies the holding period requirement.

(iv) Paragraph (c)(2)(v)(A)(I)(ii) of this section provides that a taxpayer is rebuttably presumed to have a dealing purpose unless the interest in property was used in nondealing activities for more than 24 months or 20 percent of the property's recovery period (whichever is less). The same presumption applies if the interest in property was offered for sale to customers during more than 25 percent of the period in which the interest was held in nondealing activities. In this case, the taxpayer used each apartment in a nondealing activity (the rental activity) for a period of 36 to 48 months (*i.e.*, from January 1, 1993, to the date of sale in the period from January through December 1996). Thus, the apartments were used in nondealing activities for more than 24 months, and the first of the rebuttable presumptions described above does not apply. In addition, the apartments were offered for sale to customers for up to 12 months (depending on the month in which the apartment was sold) during the period in which the apartments were used in a nondealing activity. The percentage obtained by dividing the period during which an apartment was held for sale to customers by the period during which the apartment was used in nondealing activities ranges from zero in the case of apartments sold on January 1, 1996, to 25 percent (*i.e.*, 12 months/48 months) in the case of apartments sold on December 31, 1996. Thus, no apartment was offered for sale to customers during more than 25 percent of the period in which it was used in nondealing activities, and the second rebuttable presumption does not apply.

(v) Because neither of the rebuttable presumptions in paragraph (c)(2)(v)(A)(I)(ii) of this section applies in this case, the taxpayer will not be treated as having a dealing purpose unless other facts and circumstances establish that the taxpayer acquired and held the apartments for the principal purpose of selling the apartments to customers in the ordinary course of a trade or business. Assume that none of the facts and circumstances suggest that the taxpayer had such a purpose. If that is the case, the taxpayer does not have a dealing purpose.

(vi) The marketing of the property satisfies the holding period requirement, and the taxpayer does not have a dealing purpose. Thus, holding the apartments in the tax-

payer's dealing activity is treated for purposes of this paragraph (c)(2) as the use of the apartments in a nondealing activity. In this case, the rental activity is the only nondealing activity in which the apartments were used prior to their disposition. Thus, the apartments are treated under paragraph (c)(2)(v)(A)(2) of this section as interests in property that were used only in the rental activity for the entire period during which the taxpayer held the interests. Accordingly, the rules in §1.469-2T(c)(2)(ii) and paragraph (c)(2)(iii) of this section do not apply, and all gain from the sale of the apartments is treated as passive activity gross income.

*Example 2.* (i) The taxpayer acquires a residential apartment building on January 1, 1993, and uses the building in a rental activity. The taxpayer converts the apartments into condominium units on July 1, 1993. After the conversion, the taxpayer holds the condominium units for sale to customers in the ordinary course of a trade or business of dealing in condominium units. (Assume that these are dealing operations treated as separate activities under §1.469-4, and that the taxpayer materially participates in the activities.) In addition, the taxpayer continues to use the units in the rental activity until they are sold. The first unit is sold on January 1, 1994, and the last unit is sold on December 31, 1996.

(ii) In this case, all of the apartments were simultaneously offered for sale to customers and used in a nondealing activity of the taxpayer for more than 25 percent of the period during which the apartments were used in nondealing activities. Thus, the taxpayer is rebuttably presumed to have acquired the apartments (including apartments that are used in the rental activity for at least 24 months) for the principal purpose of selling them to customers in the ordinary course of a trade or business. Assume that the facts and circumstances do not rebut this presumption. If that is the case, the taxpayer has a dealing purpose, and paragraph (c)(2)(v)(A) of this section does not apply to the disposition of the apartments.

(iii) Paragraph (c)(2)(v)(B) of this section provides that if paragraph (c)(2)(v)(A) of this section does not apply to the disposition of a taxpayer's interest in property that is held in a dealing activity of the taxpayer at the time of the disposition, the use of the interest in property in any nondealing activity of the taxpayer for any period during which the interest is also offered for sale to customers is treated as incidental to the use of the interest in the dealing activity. Accordingly, for purposes of applying the rules of §1.469-2T(c)(2) to the disposition of the apartments, the rental of the apartments after July 1, 1993, is treated as the use of the apartments in the taxpayer's dealing activity.

*Example 3.* (i) The taxpayer acquires a residential apartment building on January 1,

1993, and uses the building in a rental activity. In January 1996, the taxpayer converts the apartments into condominium units. After the conversion, the taxpayer holds the condominium units for sale to customers in the ordinary course of a trade or business of dealing in condominium units. (Assume that these are dealing operations treated as separate activities under § 1.469-4, and that the taxpayer materially participates in the activities.) In addition, the taxpayer continues to use the units in the rental activity until they are sold. The units are first held for sale on January 1, 1996, and the last unit is sold in 1997.

(i) The treatment of apartments sold in 1996 is the same as in Example 1. The apartments sold in 1997, however, were simultaneously offered for sale to customers and used in a nondealing activity for more than 25 percent of the period during which the apartments were used in nondealing activities. (For example, an apartment that is sold on January 31, 1997, has been offered for sale for 13 months or 26.1 percent of the 49-month period during which it was used in nondealing activities.) Thus, the taxpayer is rebuttably presumed to have acquired the apartments sold in 1997 for the principal purpose of selling them to customers in the ordinary course of a trade or business. Assume that the facts and circumstances do not rebut this presumption. In that case, the marketing of the apartments sold in 1997 does not satisfy the principal purpose requirement, and paragraph (c)(2)(v)(A) of this section does not apply to the disposition of those apartments. Accordingly, for purposes of applying the rules of § 1.469-2T(c)(2) to the disposition of the apartments sold in 1997, the rental of the apartments after January 1, 1996, is treated, under paragraph (c)(2)(v)(B) of this section, as the use of the apartments in the taxpayer's dealing activity.

(c)(3)-(c)(5) [Reserved]

(c)(6) *Gross income from certain oil or gas properties*—(i) *In general.* Notwithstanding any other provision of the regulations under section 469, passive activity gross income for any taxable year does not include an amount of the taxpayer's gross passive income for the year from a property described in this paragraph (c)(6)(i) equal to the taxpayer's net passive income from the property for the year. Property is described in this paragraph (c)(6)(i) if the property is—

(A) An oil or gas property that includes an oil or gas well if, for any prior taxable year beginning after December 31, 1986, any of the taxpayer's loss from the well was treated, solely by reason of § 1.469-1T(e)(4) (relating to

a special rule for losses from oil and gas working interests), and not by reason of the taxpayer's material participation in the activity, as a loss that is not from a passive activity; or

(B) Any property the basis of which is determined in whole or in part by reference to the basis of property described in paragraph (c)(6)(i)(A) of this section.

(ii) *Gross and net passive income from the property.* For purposes of this paragraph (c)(6)—

(A) The taxpayer's gross passive income for any taxable year from any property described in paragraph (c)(6)(i) of this section is any passive activity gross income for the year (determined without regard to this paragraph (c)(6) and § 1.469-2T(f)) from the property;

(B) The taxpayer's net passive income for any taxable year from any property described in paragraph (c)(6)(i) of this section is the excess, if any, of—

(1) The taxpayer's gross passive income for the taxable year from the property; over

(2) Any passive activity deductions for the taxable year (including any deduction treated as a deduction for the year under § 1.469-1T(f)(4)) that are reasonably allocable to the income; and

(C) If any oil or gas well or other item of property (the item) is included in two or more properties described in paragraph (c)(6)(i) of this section (the properties), the taxpayer must allocate the passive activity gross income (determined without regard to this paragraph (c)(6) and § 1.469-2T(f)) from the item and the passive activity deductions reasonably allocable to the item among the properties.

(iii) *Property.* For purposes of paragraph (c)(6)(i)(A) of this section, the term "property" does not have the meaning given the term by section 614(a) or the regulations thereunder, and an oil or gas property that includes an oil or gas well is—

(A) The well; and

(B) Any other item of property (including any oil or gas well) the value of which is directly enhanced by any drilling, logging, seismic testing, or other activities the costs of which were taken into account in determining the

amount of the taxpayer's income or loss from the well.

(iv) *Examples.* The following examples illustrate the application of this paragraph (c)(6):

*Example 1.* A is a general partner in partnership P and a limited partner in partnership R. P and R own oil and gas working interests in two separate tracts of land acquired from two separate landowners. In 1993, P drills a well on its tract, and A's distributive share of P's losses from drilling the well are treated under §1.469-1T(e)(4) as not from a passive activity. In the course of selecting the drilling site and drilling the well, P develops information indicating that the reservoir in which the well was drilled underlies R's tract as well as P's. Under these facts, P's and R's tracts are treated as one property for purposes of this paragraph (c)(6), even if A's interests in the mineral deposits in the tracts are treated as separate properties under section 614(a). Accordingly, in 1994 and subsequent years, A's distributive share of both P's and R's income and expenses from their respective tracts is taken into account in computing A's net passive income from the property for purposes of this paragraph (c)(6).

*Example 2.* B is a general partner in partnership S. S owns an oil and gas working interest in a single tract of land. In 1993, S drills a well, and B's distributive share of S's losses from drilling the well is treated under §1.469-1T(e)(4) as not from a passive activity. In the course of drilling the well, S discovers two oil-bearing formations, one underlying the other. On December 1, 1993, S completes the well in the underlying formation. On January 1, 1994, B converts B's entire general partnership interest in S into a limited partnership interest. In 1994, S completes in, and commences production from, the shallow formation. Under these facts, the two mineral deposits in S's tract are treated as one property for purposes of this paragraph (c)(6), even if they are treated as separate properties under section 614(a). Accordingly, B's distributive share of S's income and expenses from both the underlying formation and from recompletion in and production from the shallow formation is taken into account in computing B's net passive income from the property for purposes of this paragraph (c)(6).

(c)(6)(iv) *Example 3—(c)(7)(iii)* [Reserved]

(c)(7)(iv) Gross income of an individual from a covenant by such individual not to compete;

(v) Gross income that is treated as not from a passive activity under any provision of the regulations under section 469, including but not limited to

§1.469-1T(h)(6) (relating to income from intercompany transactions of members of an affiliated group of corporations filing a consolidated return) and §1.469-2T(f) and paragraph (f) of this section (relating to recharacterized passive income);

(vi) Gross income attributable to the reimbursement of a loss from fire, storm, shipwreck, or other casualty, or from theft (as such terms are used in section 165(c)(3)) if—

(A) The reimbursement is included in gross income under §1.165-1(d)(2)(iii) (relating to reimbursements of losses that the taxpayer deducted in a prior taxable year); and

(B) The deduction for the loss was not a passive activity deduction; and

(c)(7)(vii) Gross income or gain allocable to business or rental use of a dwelling unit for any taxable year in which section 280A(c)(5) applies to such business or rental use.

(d)(1)–(d)(2)(viii) [Reserved]

(ix) An item of loss or deduction that is carried to the taxable year under section 172(a), section 613A(d), section 1212(a)(1) (in the case of corporations), or section 1212(b) (in the case of taxpayers other than corporations);

(x) An item of loss or deduction that would have been allowed for a taxable year beginning before January 1, 1987, but for section 704(d), 1366, or 465;

(xi) A deduction for a loss from fire, storm, shipwreck, or other casualty, or from theft (as such terms are used in section 165(c)(3)) if losses that are similar in cause and severity do not recur regularly in the conduct of the activity; and

(xii) A deduction or loss allocable to business or rental use of a dwelling unit for any taxable year in which section 280A(c)(5) applies to such business or rental use.

(d)(3)–(d)(5)(ii) [Reserved]

(d)(5)(iii) *Other applicable rules—(A) Applicability of rules in §1.469-2T(c)(2).* For purposes of this paragraph (d)(5), a taxpayer's interests in property used in an activity and the amounts allocated to the interests shall be determined under §1.469-2T(c)(2)(i)(C). In addition, the rules contained in paragraph (c)(2)(iv) and (v) of this section apply in determining for purposes of this paragraph (d)(5) the activity (or activities)

in which an interest in property is used at the time of its disposition and during the 12-month period ending on the date of its disposition.

(d)(5)(iii)(B)–(d)(6)(v)(D) [Reserved]

(d)(6)(v)(E) Are taken into account under section 613A(d) (relating to limitations on certain depletion deductions), section 1211 (relating to the limitation on capital losses), or section 1231 (relating to property used in a trade or business and involuntary conversions); or

(d)(6)(v)(F)–(d)(7) [Reserved]

(d)(8) *Taxable year in which item arises.*

For purposes of § 1.469-2T(d), an item of deduction arises in the taxable year in which the item would be allowable as a deduction under the taxpayer's method of accounting if taxable income for all taxable years were determined without regard to sections 469, 613A(d) and 1211.

(e)(1)–(e)(2)(i) [Reserved]

(e)(2)(ii) *Section 707(c).* Except as provided in paragraph (e)(2)(iii)(B) of this section, any payment to a partner for services or the use of capital that is described in section 707(c), including any payment described in section 736(a)(2) (relating to guaranteed payments made in liquidation of the interest of a retiring or deceased partner), is characterized as a payment for services or as the payment of interest, respectively, and not as a distributive share of partnership income.

(iii) *Payments in liquidation of a partner's interest in partnership property—(A) In general.* If any gain or loss is taken into account by a retiring partner (or any other person that owns (directly or indirectly) an interest in the partner if the partner is a passthrough entity) or a deceased partner's successor in interest as a result of a payment to which section 736(b) (relating to payments made in exchange for a retired or deceased partner's interest in partnership property) applies, the gain or loss is treated as passive activity gross income or a passive activity deduction only to the extent that the gain or loss would have been passive activity gross income or a passive activity deduction of the retiring or deceased partner (or the other person) if it had been recognized at the time the liquidation of the partner's interest commenced.

(B) *Payments in liquidation of a partner's interest in unrealized receivables and goodwill under section 736(a).* (1) If a payment is made in liquidation of a retiring or deceased partner's interest, the payment is described in section 736(a), and any income—

(i) Is taken into account by the retiring partner (or any other person that owns (directly or indirectly) an interest in the partner if the partner is a passthrough entity) or the deceased partner's successor in interest as a result of the payment; and

(ii) Is attributable to the portion (if any) of the payment that is allocable to the unrealized receivables (within the meaning of section 751(c)) and goodwill of the partnership;

the percentage of the income that is treated as passive activity gross income shall not exceed the percentage of passive activity gross income that would be included in the gross income that the retiring or deceased partner (or the other person) would have recognized if the unrealized receivables and goodwill had been sold at the time that the liquidation of the partner's interest commenced.

(2) For purposes of this paragraph (e)(2)(iii)(B), the portion (if any) of a payment under section 736(a) that is allocable to unrealized receivables and goodwill of a partnership shall be determined in accordance with the principles employed under § 1.736-1(b) for determining the portion of a payment made under section 736 that is treated as a distribution under section 736(b).

(e)(3)(i)–(iii)(A) [Reserved]

(B) An amount of gain that would have been treated as gain that is not from a passive activity under paragraph (c)(2)(iii) of this section (relating to substantially appreciated property formerly used in a nonpassive activity), paragraph (c)(6) of this section (relating to certain oil or gas properties), § 1.469-2T(f)(5) (relating to certain property rented incidental to development), paragraph (f)(6) of this section (relating to property rented to a nonpassive activity), or § 1.469-2T(f)(7) (relating to certain interests in a passthrough entity engaged in the trade or business of licensing intangible property) would have been allocated to the holder (or such other person) with respect to the

interest if all of the property used in the passive activity had been sold immediately prior to the disposition for its fair market value on the applicable valuation date (within the meaning of § 1.469-2T(e)(3)(ii)(D)(I)); and

(e)(3)(iii)(C)–(f)(4) [Reserved]

(f)(5) *Net income from certain property rented incidental to development activity*—(i) *In general.* An amount of the taxpayer's gross rental activity income for the taxable year from an item of property equal to the net rental activity income for the year from the item of property shall be treated as not from a passive activity if—

(A) Any gain from the sale, exchange, or other disposition of the item of property is included in the taxpayer's income for the taxable year;

(B) The taxpayer's use of the item of property in an activity involving the rental of the property commenced less than 12 months before the date of the disposition (within the meaning of paragraph (c)(2)(iii)(B) of this section) of such property; and

(C) The taxpayer materially participated (within the meaning of § 1.469-5T) or significantly participated (within the meaning of § 1.469-5T(c)(2)) for any taxable year in an activity that involved for such year the performance of services for the purpose of enhancing the value of such item of property (or any other item of property if the basis of the item of property that is sold, exchanged, or otherwise disposed of is determined in whole or in part by reference to the basis of such other item of property).

(ii) *Commencement of use*—(A) *In general.* For purposes of paragraph (f)(5)(i)(B) of this section, a taxpayer's use of an item of property in an activity involving the rental of the property commences on the first date on which—

(1) The taxpayer owns an interest in the property;

(2) Substantially all of the property is rented (or is held out for rent and is in a state of readiness for rental); and

(3) No significant value-enhancing services (within the meaning of paragraph (f)(5)(ii)(B) of this section) remain to be performed.

(B) *Value-enhancing services.* For purposes of this paragraph (f)(5)(ii), the

term value-enhancing services means the services described in paragraphs (f)(5)(i)(C) and (iii) of this section, except that the term does not include lease-up. Thus, in cases in which this paragraph (f)(5) applies solely because substantial lease-up remains to be performed (see paragraph (f)(5)(iii)(C) of this section), the twelve month period described in paragraph (f)(5)(i)(B) of this section will begin when the taxpayer acquires an interest in the property if substantially all of the property is held out for rent and is in a state of readiness for rental on that date.

(iii) *Services performed for the purpose of enhancing the value of property.* For purposes of paragraph (f)(5)(i)(C) of this section, services that are treated as performed for the purpose of enhancing the value of an item of property include but are not limited to—

(A) Construction;

(B) Renovation; and

(C) Lease-up (unless more than 50 percent of the property is leased on the date that the taxpayer acquires an interest in the property).

(iv) *Examples.* The following examples illustrate the application of this paragraph (f)(5):

*Example 1.* (i) A, a calendar year individual, is a partner in P, a calendar year partnership, which develops real estate. In 1993, P acquires an interest in undeveloped land and arranges for the financing and construction of an office building on the land. Construction is completed in February 1995, and substantially all of the building is either rented or held out for rent and in a state of readiness for rental beginning on March 1, 1995. Twenty percent of the building is leased as of March 1, 1995.

(ii) P rents the building (or holds it out for rent) for the remainder of 1995 and all of 1996, and sells the building on February 1, 1997, pursuant to a contract entered into on January 15, 1996. P did not hold the building (or any other buildings) for sale to customers in the ordinary course of P's trade or business (see paragraph (c)(2)(v) of this section). A's distributive share of P's taxable losses from the rental of the building is \$50,000 for 1995 and \$30,000 for 1996. All of A's losses from the rental of the building are disallowed under 1.469-1(a)(1)(i) (relating to the disallowance of the passive activity loss for the taxable year). A's distributive share of P's gain from the sale of the building is \$150,000. A has no other gross income or deductions from the activity of renting the building.



(iii) The real estate development activity that A holds through P in 1993, 1994, and 1995 involves the performance of services (e.g., construction) for the purpose of enhancing the value of the building. Accordingly, an amount equal to A's net rental activity income from the building may be treated as gross income that is not from a passive activity if A's use of the building in an activity involving the rental of the building commenced less than 12 months before the date of the disposition of the building. In this case, the date of the disposition of the building is January 15, 1996, the date of the binding contract for its sale.

(iv)(A) A taxpayer's use of an item of property in an activity involving the rental of the property commences on the first date on which—

(1) The taxpayer owns an interest in the item of property;

(2) Substantially all of the property is rented (or is held out for rent and is in a state of readiness for rental); and

(3) No significant value-enhancing services (within the meaning of paragraph (f)(5)(ii)(B) of this section) remain to be performed.

(B) In this case, A's use of the building in an activity involving the rental of the building commenced on March 1, 1995, less than 12 months before January 15, 1996, the date of disposition. Accordingly, if A materially (or significantly) participated in the real estate development activity in 1993, 1994, or 1995 (without regard to whether A materially participated in the activity in more than one of those years), an amount of A's gross rental activity income from the building for 1997 equal to A's net rental activity income from the building for 1997 is treated under this paragraph (f)(5) as gross income that is not from a passive activity. Under paragraph (f)(9)(iv) of this section, A's net rental activity income from the building for 1997 is \$70,000 (\$150,000 distributive share of gain from the disposition of the building minus \$80,000 of reasonably allocable passive activity deductions).

*Example 2.* (i) X, a calendar year taxpayer subject to section 469, acquires a building on February 1, 1994, when the building is 25 percent leased. During 1994, X rents the building (or holds it out for rent) and materially participates in an activity that involves the lease-up of the building. X's activities do not otherwise involve the performance of construction or other services for the purpose of enhancing the value of the building, and X does not hold the building (or any other building) for sale to customers in the ordinary course of X's trade or business. X sells the building on December 1, 1994.

(ii)(A) Under paragraph (f)(5)(iii)(C) of this section, lease-up is considered a service performed for the purpose of enhancing the value of property unless more than 50 percent of the property is leased on the date the

taxpayer acquires an interest in the property. Under paragraph (f)(5)(ii)(B) of this section, however, lease-up is not considered a value-enhancing service for purposes of determining when the taxpayer commences using an item of property in an activity involving the rental of the property. Accordingly, X's acquisition of the building constitutes a commencement of X's use of the building in a rental activity, because February 1, 1994, is the first date on which—

(1) The taxpayer owns an interest in the item of property;

(2) Substantially all of the property is held out for rent; and

(3) No significant value-enhancing services (within the meaning of paragraph (f)(5)(ii)(B) of this section) remain to be performed.

(B) In this case, X disposes of the property within 12 months of the date X commenced using the building in a rental activity. Accordingly, an amount of X's gross rental activity income for 1994 equal to X's net rental activity income from the building for 1994 is treated under this paragraph (f)(5) as gain that is not from a passive activity.

*Example 3.* The facts are the same as in Example 2, except that at the time X acquires the building it is 60 percent leased. Under paragraph (f)(5)(iii)(C) of this section, lease-up is not considered a service performed for the purpose of enhancing the value of property if more than 50 percent of the property is leased on the date the taxpayer acquires an interest in the property. Therefore, additional lease-up performed by X is not taken into account under this paragraph (f)(5). Since X's activities do not otherwise involve the performance of services for the purpose of enhancing the value of the building, none of X's gross rental activity income from the building will be treated as income that is not from a passive activity under this paragraph (f)(5).

(f)(6) *Property rented to a nonpassive activity.* An amount of the taxpayer's gross rental activity income for the taxable year from an item of property equal to the net rental activity income for the year from that item of property is treated as not from a passive activity if the property—

(i) Is rented for use in a trade or business activity (within the meaning of paragraph (e)(2) of this section) in which the taxpayer materially participates (within the meaning of § 1.469-5T) for the taxable year; and

(ii) Is not described in § 1.469-2T(f)(5).

(f)(7)–(f)(9)(ii) [Reserved]

(f)(9)(iii) The gross rental activity income for a taxable year from an item of property is any passive activity

gross income (determined without regard to § 1.469-2T(f)(2) through (f)(6)) that—

(A) Is income for the year from the rental or disposition of such item of property; and

(B) In the case of income from the disposition of such item of property, is income from an activity that involved the rental of such item of property during the 12-month period ending on the date of the disposition (see § 1.469-2T(c)(2)(ii)); and

(iv) The net rental activity income from an item of property for the taxable year is the excess, if any, of—

(A) The gross rental activity income from the item of property for the taxable year; over

(B) Any passive activity deductions for the taxable year (including any deduction treated as a deduction for the year under § 1.469-1(f)(4)) that are reasonably allocable to the income.

(10) *Coordination with section 163(d)*. Gross income that is treated as not from a passive activity under § 1.469-2T(f)(3), (4), or (7) is treated as income described in section 469(e)(1)(A) and § 1.469-2T(c)(3)(i) except in determining whether—

(i) Any property is treated for purposes of section 469(e)(1)(A)(ii)(I) and § 1.469-2T(c)(3)(i)(C) as property that produces income of a type described in § 1.469-2T(c)(3)(i)(A);

(ii) Any property is treated for purposes of section 469(e)(1)(A)(ii)(II) and § 1.469-2T(c)(3)(i)(D) as property held for investment;

(iii) An expense (other than interest expense) is treated for purposes of section 469(e)(1)(A)(i)(II) and § 1.469-2T(d)(4) as clearly and directly allocable to portfolio income (within the meaning of § 1.469-2T(c)(3)(i)); and

(iv) Interest expense is allocated under § 1.163-8T to an investment expenditure (within the meaning of § 1.163-8T(b)(3)) or to a passive activity expenditure (within the meaning of § 1.163-8T(b)(4)).

(11) [Reserved]

[T.D. 8417, 57 FR 20754, May 15, 1992, as amended by T.D. 8477, 58 FR 11538, Feb. 26, 1993; 58 FR 13706, Mar. 15, 1993; 58 FR 29536, May 21, 1993; T.D. 8495, 58 FR 58787, Nov. 4, 1993; T.D. 8417, 59 FR 45623, Sept. 2, 1994]

### § 1.469-2T Passive activity loss (temporary).

(a) *Scope of this section*. This section contains rules for determining the amount of the taxpayer's passive activity loss for the taxable year for purposes of section 469 and the regulations thereunder. The rules contained in this section—

(1) Provide general guidance for identifying items of income and deduction that are taken into account in determining the amount of the passive activity loss for the taxable year;

(2) Specify particular items of income and deduction that are not taken into account in determining the amount of the passive activity loss for the taxable year; and

(3) Specify the manner in which provisions of the Internal Revenue Code and the regulations, other than section 469 and the regulations thereunder, are applied for purposes of determining the extent to which items of deduction are taken into account for a taxable year in computing the amount of the passive activity loss for such year.

(b) *Definition of passive activity loss—*

(1) *In general*. In the case of a taxpayer other than a closely held corporation (within the meaning of § 1.469-1T(g)(2)(ii)), the passive activity loss for the taxable year is the amount, if any, by which the passive activity deductions for the taxable year exceed the passive activity gross income for the taxable year.

(2) *Cross references*. See paragraph (c) of this section for the definition of "passive activity gross income," paragraph (d) of this section for the definition of "passive activity deduction," and § 1.469-1T(g)(4) for the computation of the passive activity loss of a closely held corporation.

(c) *Passive activity gross income—*(1) *In general*. Except as otherwise provided in the regulations under section 469, passive activity gross income for a taxable year includes an item of gross income if and only if such income is from a passive activity.

(2) *Treatment of gain from disposition of an interest in an activity or an interest in property used in an activity—*(i) *In general—*(A) *Treatment of gain*. Except as otherwise provided in the regulations under section 469, any gain recognized