

ending with the taxable year of the entity ending with or within the taxpayer's current taxable year exceeds 25 percent of the fair market value of the taxpayer's interest in such property at the time the taxpayer acquired the interest in the entity.

(iv) *Capital expenditures.* For purposes of paragraph (f)(7)(iii)(B) of this section, a capital expenditure shall be taken into account for the taxable year of the entity in which such expenditure is chargeable to capital account, and the taxpayer's share of such expenditure shall be determined as though such expenditure were allowed as a deduction for such year.

(v) *Example.* The following example illustrates the application of this paragraph (f)(7):

Example. (i) The facts are the same as in example (5) in paragraph (c)(3)(iv) of this section, except that, in 1988, D's 10 percent partnership interest is sold to F for \$13,000, all of which is attributable to the design licensed by the partnership.

(ii) For 1988, the expenditures reasonably incurred by the partnership with respect to the development or marketing of the design satisfy paragraph (c)(3)(iii)(B)(2)(ii)(a) of this section. Accordingly, under paragraph (f)(7)(iii)(A) of this section, paragraph (f)(7)(i) of this section does not apply to F's distributive share of the partnership's gross income from licensing the design.

(iii) For 1989, the expenditures reasonably incurred by the partnership with respect to the development or marketing of the design do not satisfy paragraph (c)(3)(iii)(B)(2)(ii)(a) of this section. Moreover, F's distributive share of such expenditures reasonably incurred by the partnership for 1988 and 1989 ($\$27,000 \times .10 = \$2,700$) does not exceed 25 percent of the fair market value of F's interest in the design at the time F acquired the partnership interest (\$13,000). Accordingly, neither of the exceptions provided in paragraph (f)(7)(iii) of this section applies for 1989 and, under paragraph (f)(7)(i) of this section, an amount of F's gross royalty income from the design equal to F's net royalty income from the design is treated as not from a passive activity.

(8) *Limitation on recharacterized income.* The amount of gross income from an activity that is treated as not from a passive activity for the taxable year under subparagraphs (f) (2) through (4) of this paragraph (f) shall not exceed the greatest amount of gross income treated as not from a passive activity under any one of such subparagraphs.

(9) *Meaning of certain terms.* For purposes of this paragraph (f), the terms set forth below shall have the following meanings:

(i) The net passive income from an activity for a taxable year is the amount by which the taxpayer's passive activity gross income from the activity for the taxable year (determined without regard to paragraphs (f) (2) through (4) of this section) exceeds the taxpayer's passive activity deductions from the activity for such year;

(ii) The net passive loss from an activity for a taxable year is the amount by which the taxpayer's passive activity deductions from the activity for the taxable year exceeds the taxpayer's passive activity gross income from the activity for such year (determined without regard to paragraphs (f) (2) through (4) of this section).

(iii) [Reserved]. See § 1.469-2(f)(9)(iii) for rules relating to this paragraph.

(iv) [Reserved]. See § 1.469-2(f)(9)(iv) for rules relating to this paragraph.

(10) *Coordination with section 163(d).* [Reserved]. See paragraph 1.469-2(f)(10) for rules relating to this paragraph.

(11) *Effective date.* For the effective date of the rules in this paragraph (f), see § 1.469-11T (relating to effective date and transition rules).

[T.D. 8175, 53 FR 5711, Feb. 25, 1988; 53 FR 15494, Apr. 29, 1988; as amended by T.D. 8253, 54 FR 20538, May 12, 1989; T.D. 8290, 55 FR 6981, Feb. 28, 1990; T.D. 8318, 55 FR 48108, Nov. 19, 1990; 55 FR 51688, Dec. 17, 1990; T.D. 8417, 57 FR 20758, May 15, 1992; T.D. 8477, 58 FR 11538, Feb. 26, 1993; T.D. 8495, 58 FR 58788, Nov. 4, 1993]

§ 1.469-3 Passive activity credit.

(a)-(d) [Reserved]

(e) *Coordination with section 38(b).* Any credit described in section 38(b) (1) through (5) is taken into account in computing the current year business credit for the first taxable year in which the credit is subject to section 469 and is not disallowed by section 469 and the regulations thereunder.

(f) *Coordination with section 50.* In the case of any cessation described in section 50(a) (1) or (2), the credits allocable to the taxpayer's activities under § 1.469-1(f)(4) shall be adjusted by reason of the cessation.

(g) [Reserved]

[T.D. 8417, 57 FR 20758, May 15, 1992]

§ 1.469-3T Passive activity credit (temporary).

(a) *Computation of passive activity credit.* The taxpayer's passive activity credit for the taxable year is the amount (if any) by which—

(1) The sum of all of the taxpayer's credits that are subject to section 469 for such year; exceeds

(2) The taxpayer's regular tax liability allocable to all passive activities for such year.

(b) *Credits subject to section 469—(1) In general.* Except as otherwise provided in this paragraph (b), a credit is subject to section 469 for a taxable year if and only if—

(i) Such credit—

(A) Is attributable to such taxable year and arises in connection with the conduct of an activity that is a passive activity for such taxable year; and

(B) Is described in—

(1) Section 38(b) (1) through (5) (relating to general business credits);

(2) Section 27(b) (relating to corporations described in section 936);

(3) Section 28 (relating to clinical testing of certain drugs); or

(4) Section 29 (relating to fuel from nonconventional sources); or

(ii) Such credit is allocable to an activity for such taxable year under § 1.469-1T(f)(4).

(2) *Treatment of credits attributable to qualified progress expenditures.* Any credit attributable to an increase in qualified investment under section 46(d)(1)(A) (relating to qualified progress expenditures) with respect to progress expenditure property (as defined in section 46(d)(2)) is subject to section 469 for a taxable year if—

(i) Such credit is attributable to such taxable year;

(ii) Such credit is described in paragraph (b)(1)(i)(B) of this section; and

(iii) It is reasonable to believe that such progress expenditure property will be used in a passive activity of the taxpayer when it is placed in service.

(3) *Special rule for partners and S corporation shareholders.* The character of a credit of a taxpayer arising in connection with an activity conducted by a partnership or S corporation (as a

credit subject to section 469) shall be determined, in any case in which participation is relevant, by reference to the participation of the taxpayer in such activity. Such participation is determined for the taxable year of the partnership or S corporation (and not the taxable year of the taxpayer). See § 1.469-2T(e)(1).

(4) *Exception for pre-1987 credits.* A credit is not subject to section 469 if it is attributable to a taxable year of the taxpayer beginning prior to January 1, 1987.

(c) *Taxable year to which credit is attributable.* A credit is attributable to the taxable year in which such credit would be (or would have been) allowed if the credits regard to the limitations contained in sections 26(a), 28(d)(2), 29(b)(5), 38(c), and 469.

(d) *Regular tax liability allocable to passive activities—(1) In general.* For purposes of paragraph (a)(2) of this section, the taxpayer's regular tax liability allocable to all passive activities for the taxable year is the excess (if any) of—

(i) The taxpayer's regular tax liability for such taxable year; over

(ii) The amount of such regular tax liability determined by reducing the taxpayer's taxable income for such year by the excess (if any) of the taxpayer's passive activity gross income for such year over the taxpayer's passive activity deductions for such year.

(2) *Regular tax liability.* For purposes of this section, the term "regularly tax liability" has the meaning given such term in section 26(b).

(e) *Coordination with section 38(b).* [Reserved]. See § 1.469-3(e) for rules relating to this paragraph.

(f) *Coordination with section 50.* [Reserved]. See § 1.469-3(f) for rules relating to this paragraph.

(g) *Examples.* The following examples illustrate the application of this section:

Example (1). (i) A, a calendar year individual, is a general partner in calendar year partnership P. P purchases a building in 1987 and, in 1987, 1988, and 1989, incurs rehabilitation costs with respect to the building. The building is placed in service in the rental activity in 1989. P's rehabilitation costs are qualified rehabilitation expenditures (within the meaning of section 48(g)(2)) and are taken into account in determining the