the passthrough entity will be treated as a separate interest in rental real estate of the qualifying taxpayer, regardless of the passthrough entity's grouping of activities under §1.469–4(d)(5). However, the qualifying taxpayer may elect under paragraph (g) of this section to treat all interests in rental real estate, including the rental real estate interests held through passthrough entities, as a single rental real estate activity.

(3) *Special rule for interests held in tiered passthrough entities.* If a passthrough entity owns a fifty-percent or greater interest in the capital, profits, or losses of another passthrough entity for a taxable year, each interest in rental real estate held by the lower-tier entity will be treated as a separate interest in rental real estate of the upper-tier entity, regardless of the lower-tier entity's grouping of activities under §1.469–4(d)(5).

(i) [Reserved]

(j) *$25,000 offset for rental real estate activities of qualifying taxpayers*—(1) *In general.* A qualifying taxpayer's passive losses and credits from rental real estate activities (including prior-year disallowed passive activity losses and credits from rental real estate activities in which the taxpayer materially participates) are allowed to the extent permitted under section 469(i). The amount of losses or credits allowable under section 469(i) is determined after the rules of this section are applied. However, losses allowable by reason of this section are not taken into account in determining adjusted gross income for purposes of section 469(i)(3).

(2) *Example.* The following example illustrates the application of this paragraph (j).

Example (i) Taxpayer *A* owns building *X* and building *Y*, both interests in rental real estate. In 1995, *A* is a qualifying taxpayer within the meaning of paragraph (c) of this section. *A* does not elect to treat *X* and *Y* as one activity under section 469(c)(7)(A) and paragraph (g) of this section. As a result, *X* and *Y* are treated as separate activities pursuant to section 469(c)(7)(A)(ii). *A* materially participates in *X* which has $100,000 of passive losses disallowed from prior years and produces $20,000 of losses in 1995. *A* does not materially participate in *Y* which produces $40,000 of income in 1995. *A* also has $50,000 of income from other nonpassive sources in 1995. *A* otherwise meets the requirements of section 469(i).

(ii) Because *X* is not a passive activity in 1995, the $20,000 of losses produced by *X* in 1995 are nonpassive losses that may be used by *A* to offset part of the $50,000 of nonpassive income. Accordingly, *A* is left with $30,000 ($50,000–$20,000) of nonpassive income. In addition, A may use the prior year disallowed passive losses of *X* to offset any income from *X* and passive income from other sources. Therefore, *A* may offset the $40,000 of passive income from *Y* with $40,000 of passive losses from *X*.

(iii) Because *A* has $60,000 ($100,000–$40,000) of passive losses remaining from *X* and meets all of the requirements of section 469(i), *A* may offset up to $25,000 of nonpassive income with passive losses from *X* pursuant to section 469(i). As a result, *A* has $5,000 ($30,000–$25,000) of nonpassive income remaining and disallowed passive losses from *X* of $35,000 ($60,000–$25,000) in 1995.

[T.D. 8645, 60 FR 66499, Dec. 22, 1995]

§1.469–10 Application of section 469 to publicly traded partnerships.

(a) [Reserved]

(b) *Publicly traded partnership*—(1) *In general.* For purposes of section 469(k), a partnership is a publicly traded partnership only if the partnership is a publicly traded partnership as defined in §1.7704–1.

(2) *Effective date.* This section applies for taxable years of a partnership beginning on or after December 17, 1998.

[T.D. 8799, 63 FR 69553, Dec. 17, 1998]

§1.469–11 Effective date and transition rules.

(a) *Generally applicable effective dates.* Except as otherwise provided in this section—

(1) The rules contained in §§1.469–1, 1.469–1T, 1.469–2, 1.469–2T, 1.469–3, 1.469–3T, 1.469–4, 1.469–5, and 1.469–5T apply for taxable years ending after May 10, 1992.

(2) The rules contained in 26 CFR 1.469–1T, 1.469–2T, 1.469–3T, 1.469–4T, 1.469–5T, 1.469–11T (b) and (c) (as contained in the CFR edition revised as of April 1, 1992) apply for taxable years beginning after December 31, 1986, and ending on or before May 10, 1992;

(3) The rules contained in §1.469–9 apply for taxable years beginning on or after January 1, 1995, and to elections made under §1.469–9(g) with returns filed on or after January 1, 1995;

(4) The rules contained in §1.469–7 apply for taxable years ending after December 31, 1986; and

(5) This section applies for taxable years beginning after December 31, 1986.

(b) *Additional effective dates*—(1) *Application of 1992 amendments for taxable years beginning before October 4, 1994.* Except as provided in paragraph (b)(2) of this section, for taxable years that end after May 10, 1992, and begin before October 4, 1994, a taxpayer may determine tax liability in accordance with Project PS–1–89 published at 1992–1 C.B. 1219 (see §601.601(d)(2)(ii)(b) of this chapter).

(2) *Additional transition rule for 1992 amendments.* If a taxpayer's first taxable year ending after May 10, 1992, begins on or before that date, the taxpayer may treat the taxable year, for purposes of paragraph (a) of this section, as a taxable year ending on or before May 10, 1992.

(3) *Fresh starts under consistency rules*—(i) *Regrouping when tax liability is first determined under Project PS–1–89.* For the first taxable year in which a taxpayer determines its tax liability under Project PS–1–89, the taxpayer may regroup its activities without regard to the manner in which the activities were grouped in the preceding taxable year and must regroup its activities if the grouping in the preceding taxable year is inconsistent with the rules of Project PS–1–89.

(ii) *Regrouping when tax liability is first determined under §1.469–4.* For the first taxable year in which a taxpayer determines its tax liability under §1.469–4, rather than under the rules of Project PS–1–89, the taxpayer may regroup its activities without regard to the manner in which the activities were grouped in the preceding taxable year and must regroup its activities if the grouping in the preceding taxable year is inconsistent with the rules of §1.469–4.

(iii) *Regrouping when taxpayer is first subject to section 469(c)(7).* For the first taxable year beginning after December 31, 1993, a taxpayer may regroup its activities to the extent necessary or appropriate to avail itself of the provisions of section 469(c)(7) and without regard to the manner in which the activities were grouped in the preceding taxable year.

(4) *Certain investment credit property.* (i) The rules contained in §1.469–3(f) apply with respect to property placed in service after December 31, 1990 (other than property described in section 11813 (c)(2) of the Omnibus Reconciliation Act of 1990 (P.L. 101–508)).

(ii) The rules contained in 26 CFR 1.469–3T(f) (as contained in the CFR edition revised as of April 1, 1992) apply with respect to property placed in service on or before December 31, 1990, and property described in section 11813(c)(2) of the Omnibus Reconcilation Act of 1990.

(c) *Special rules*—(1) *Application of certain income recharacterization rules and self-charged rules*—(i) *Certain recharacterization rules inapplicable in 1987.* No amount of gross income shall be treated under §1.469–2T(f)(3) through (7) as income that is not from a passive activity for any taxable year of the taxpayer beginning before January 1, 1988.

(ii) *Property rented to a nonpassive activity.* In applying §1.469–2(f)(6) or §1.469–2T(f)(6) to a taxpayer's rental of an item of property, the taxpayer's net rental activity income (within the meaning of §1.469–2(f)(9)(iv) or §1.469–2T(f)(9)(iv)) from the property for any taxable year beginning after December 31, 1987, does not include the portion of the income (if any) that is attributable to the rental of that item of property pursuant to a written binding contract entered into before February 19, 1988.

(iii) *Self-charged rules.* For taxable years beginning before June 4, 1991—

(*1*) A taxpayer is not required to apply the rules in §1.469–7 in computing the taxpayer's passive activity loss and passive activity credit; and

(*2*) A taxpayer that owns an interest in a passthrough entity may use any reasonable method of offsetting items of interest income and interest expense from lending transactions between the passthrough entity and its owners or between identically-owned passthrough entities (as defined in §1.469–7(e)) to compute the taxpayer's passive activity loss and passive activity credit. Items from nonlending transactions cannot be offset under the self-charged rules.

(2) *Qualified low-income housing projects.* For a transitional rule concerning the application of section 469 to losses from qualified low-income housing projects, see section 502 of the Tax Reform Act of 1986.

(3) *Effect of events occurring in years prior to 1987.* The treatment for a taxable year beginning after December 31, 1986, of any item of income, gain, loss, deduction, or credit as an item of passive activity gross income, passive activity deduction, or credit from a passive activity, is determined as if section 469 and the regulations thereunder had been in effect for taxable years beginning before January 1, 1987, but without regard to any passive activity loss or passive activity credit that would have been disallowed for any taxable year beginning before January 1, 1987, if section 469 and the regulations thereunder had been in effect for that year. For example, in determining whether a taxpayer materially participates in an activity under §1.469–5T(a)(5) (relating to taxpayers who have materially participated in an activity for five of the ten immediately preceding taxable years) for any taxable year beginning after December 31, 1986, the taxpayer's participation in the activity for all prior taxable years (including taxable years beginning before 1987) is taken into account. See §1.469–5(j) (relating to the determination of material participation for taxable years beginning before January 1, 1987).

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

Example 1. A, a calendar year individual, is a partner in a partnership with a taxable year ending on January 31. During its taxable year ending January 31, 1987, the partnership was engaged in a single activity involving the conduct of a trade or business. In applying section 469 and the regulations thereunder to A for calendar year 1987, A's distributive share of partnership items for the partnership's taxable year ending January 31, 1987, is taken into account. Therefore, under §1.469–2T(e)(1) and paragraph (c)(3) of this section, A's participation in the activity throughout the partnership's taxable year beginning February 1, 1986, and ending January 31, 1987, is taken into account for purposes of determining the character under section 469 of the items of gross income, deduction, and credit allocated to A for the partnership's taxable year ending January 31, 1987.

Example 2. B, a calendar year individual, is a beneficiary of a trust described in section 651 that has a taxable year ending January 31. The trust conducts a rental activity (within the meaning of §1.469–1T(e)(3)). Because the trust's taxable year ending January 31, 1987, began before January 1, 1987, section 469 and the regulations thereunder do not applying to the trust for that year. Section 469 and the regulations thereunder do apply, however, to B for B's calender year 1987. Therefore, income of the trust from the rental activity for the trust's taxable year ending January 31, 1987, that is included in B's gross income for 1987 is taken into account in apply section 469 to B for 1987.

[T.D. 8417, 57 FR 20759, May 15, 1992, as amended by T.D. 8417, 59 FR 45623, Sept. 2, 1994; T.D. 8565, 59 FR 50489, Oct. 4, 1994; T.D. 8645, 60 FR 66501, Dec. 22, 1995; T.D. 9013, 67 FR 54093, Aug. 21, 2002]

INVENTORIES

§ 1.471–1 Need for inventories.

In order to reflect taxable income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include all finished or partly finished goods and, in the case of raw materials and supplies, only those which have been acquired for sale or which will physically become a part of merchandise intended for sale, in which class fall containers, such as kegs, bottles, and cases, whether returnable or not, if title thereto will pass to the purchaser of the product to be sold therein. Merchandise should be included in the inventory only if title thereto is vested in the taxpayer. Accordingly, the seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold (including containers), title to which has passed to the purchaser. A purchaser should include in inventory merchandise purchased (including containers), title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery,