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## **Internal Revenue Code Section 465**

### **Deductions limited to amount at risk**

(a) Limitation to amount at risk.

(1) In general.

In the case of-

(A) an individual, and

(B) a C corporation with respect to which the stock ownership requirement of paragraph (2) of section 542(a) is met,

engaged in an activity to which this section applies, any loss from such activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is at risk (within the meaning of subsection (b) ) for such activity at the close of the taxable year.

(2) Deduction in succeeding year.

Any loss from an activity to which this section applies not allowed under this section for the taxable year shall be treated as a deduction allocable to such activity in the first succeeding taxable year.

(3) Special rules for applying paragraph (1)(B) .

For purposes of paragraph (1)(B) -

(A) section 544(a)(2) shall be applied as if such section did not contain the phrase "or by or for his partner"; and

(B) sections 544(a)(4)(A) and 544(b)(1) shall be applied by substituting "the corporation meet the stock ownership requirements of section 542(a)(2) " for "the corporation a personal holding company".

(b) Amounts considered at risk.

(1) In general.

For purposes of this section , a taxpayer shall be considered at risk for an activity with respect to amounts including-

(A) the amount of money and the adjusted basis of other property contributed by the taxpayer to the activity, and

(B) amounts borrowed with respect to such activity (as determined under paragraph (2) ).

(2) Borrowed amounts.

For purposes of this section , a taxpayer shall be considered at risk with respect to amounts borrowed for use in an activity to the extent that he-

(A) is personally liable for the repayment of such amounts, or

(B) has pledged property, other than property used in such activity, as security for such borrowed amount (to the extent of the net fair market value of the taxpayer's interest in such property).

No property shall be taken into account as security if such property is directly or indirectly financed by indebtedness which is secured by property described in paragraph (1) .

(3) Certain borrowed amounts excluded.

(A) In general. Except to the extent provided in regulations, for purposes of paragraph (1)(B) , amounts borrowed shall not be considered to be at risk with respect to an activity if such amounts are borrowed from any person who has an interest in such activity or from a related person to a person (other than the taxpayer) having such an interest.

(B) Exceptions.

(i) Interest as creditor. Subparagraph (A) shall not apply to an interest as a creditor in the activity.

(ii) Interest as shareholder with respect to amounts borrowed by corporation. In the case of amounts borrowed by a corporation from a shareholder, subparagraph (A) shall not apply to an interest as a shareholder.

(C) Related person. For purposes of this subsection , a person (hereinafter in this paragraph referred to as the "related person") is related to any person if-

(i) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1) , or

(ii) the related person and such person are engaged in trades or business under common control (within the meaning of subsections (a) and (b) of section 52 ).

For purposes of clause (i) , in applying section 267(b) or 707(b)(1) , "10 percent" shall be substituted for "50 percent".

(4) Exception.

Notwithstanding any other provision of this section , a taxpayer shall not be considered at risk with respect to amounts protected against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements.

(5) Amounts at risk in subsequent years.

If in any taxable year the taxpayer has a loss from an activity to which subsection (a) applies, the amount with respect to which a taxpayer is considered to be at risk (within the meaning of subsection (b) ) in subsequent taxable years with respect to that activity

shall be reduced by that portion of the loss which (after the application of subsection (a) ) is allowable as a deduction.

(6) Qualified nonrecourse financing treated as amount at risk.

For purposes of this section -

(A) In general. Notwithstanding any other provision of this subsection , in the case of an activity of holding real property, a taxpayer shall be considered at risk with respect to the taxpayer's share of any qualified nonrecourse financing which is secured by real property used in such activity.

(B) Qualified nonrecourse financing. For purposes of this paragraph , the term "qualified nonrecourse financing" means any financing-

(i) which is borrowed by the taxpayer with respect to the activity of holding real property,

(ii) which is borrowed by the taxpayer from a qualified person or represents a loan from any Federal, State, or local government or instrumentality thereof, or is guaranteed by any Federal, State, or local government,

(iii) except to the extent provided in regulations, with respect to which no person is personally liable for repayment, and

(iv) which is not convertible debt.

(C) Special rule for partnerships. In the case of a partnership, a partner's share of any qualified nonrecourse financing of such partnership shall be determined on the basis of the partner's share of liabilities of such partnership incurred in connection with such financing (within the meaning of section 752 ).

(D) Qualified person defined. For purposes of this paragraph -

(i) In general. The term "qualified person" has the meaning given such term by section 49(a)(1)(D)(iv) .

(ii) Certain commercially reasonable financing from related persons. For purposes of clause (i) , section 49(a)(1)(D)(iv) shall be applied without regard to subclause (I) thereof (relating to financing from related persons) if the financing from the related person is commercially reasonable and on substantially the same terms as loans involving unrelated persons.

(E) Activity of holding real property. For purposes of this paragraph -

(i) Incidental personal property and services. The activity of holding real property includes the holding of personal property and the providing of services which are incidental to making real property available as living accommodations.

(ii) Mineral property. The activity of holding real property shall not include the holding of mineral property.

(c) Activities to which section applies.

(1) Types of activities.

This section applies to any taxpayer engaged in the activity of-

- (A) holding, producing, or distributing motion picture films or video tapes,
- (B) farming (as defined in section 464(e) ),
- (C) leasing any section 1245 property (as defined in section 1245(a)(3) ),
- (D) exploring for, or exploiting, oil and gas resources, or
- (E) exploring for, or exploiting, geothermal deposits (as defined in section 613(e)(2) ).

as a trade or business or for the production of income.

(2) Separate activities.

For purposes of this section -

- (A) In general. Except as provided in subparagraph (B) , a taxpayer's activity with respect to each-
  - (i) film or video tape,
  - (ii) section 1245 property which is leased or held for leasing,
  - (iii) farm,
  - (iv) oil and gas property (as defined under section 614 ), or
  - (v) geothermal property (as defined under section 614 ),

shall be treated as a separate activity.

(B) Aggregation rules.

- (i) Special rule for leases of section 1245 property by partnerships or S corporations. In the case of any partnership or S corporation, all activities with respect to section 1245 properties which-
  - (I) are leased or held for lease, and
  - (II) are placed in service in any taxable year of the partnership or S corporation,

shall be treated as a single activity.

- (ii) Other aggregation rules. Rules similar to the rules of subparagraphs (B) and (C) of paragraph (3) shall apply for purposes of this paragraph .

(3) Extension to other activities.

- (A) In general. This section also applies to each activity-

(i) engaged in by the taxpayer in carrying on a trade or business or for the production of income, and

(ii) which is not described in paragraph (1) .

(B) Aggregation of activities where taxpayer actively participates in management of trade or business. Except as provided in subparagraph (C) , for purposes of this section , activities described in subparagraph (A) which constitute a trade or business shall be treated as one activity if-

(i) the taxpayer actively participates in the management of such trade or business, or

(ii) such trade or business is carried on by a partnership or an S corporation and 65 percent or more of the losses for the taxable year is allocable to persons who actively participate in the management of the trade or business.

(C) Aggregation or separation of activities under regulations. The Secretary shall prescribe regulations under which activities described in subparagraph (A) shall be aggregated or treated as separate activities.

(D) Application of subsection (b)(3) . In the case of an activity described in subparagraph (A) , subsection (b)(3) shall apply only to the extent provided in regulations prescribed by the Secretary.

(4) Exclusion for certain equipment leasing by closely-held corporations.

(A) In general. In the case of a corporation described in subsection (a)(1)(B) actively engaged in equipment leasing-

(i) the activity of equipment leasing shall be treated as a separate activity, and

(ii) subsection (a) shall not apply to losses from such activity.

(B) 50-percent gross receipts test. For purposes of subparagraph (A) , a corporation shall not be considered to be actively engaged in equipment leasing unless 50 percent or more of the gross receipts of the corporation for the taxable year is attributable, under regulations prescribed by the Secretary, to equipment leasing.

(C) Component members of controlled group treated as a single corporation. For purposes of subparagraph (A) , the component members of a controlled group of corporations shall be treated as a single corporation.

(5) Waiver of controlled group rule where there is substantial leasing activity.

(A) In general. In the case of the component members of a qualified leasing group, paragraph (4) shall be applied-

(i) by substituting "80 percent" for "50 percent" in subparagraph (B) thereof, and

(ii) as if paragraph (4) did not include subparagraph (C) thereof.

(B) Qualified leasing group. For purposes of this paragraph , the term "qualified leasing group" means a controlled group of corporations which, for the taxable year and each of the 2 immediately preceding taxable years, satisfied each of the following 3 requirements:

(i) At least 3 employees. During the entire year, the group had at least 3 full-time employees substantially all of the services of whom were services directly related to the equipment leasing activity of the qualified leasing members.

(ii) At least 5 separate leasing transactions. During the year, the qualified leasing members in the aggregate entered into at least 5 separate equipment leasing transactions.

(iii) At least \$1,000,000 equipment leasing receipts. During the year, the qualified leasing members in the aggregate had at least \$1,000,000 in gross receipts from equipment leasing.

The term "qualified leasing group" does not include any controlled group of corporations to which, without regard to this paragraph , paragraph (4) applies.

(C) Qualified leasing member. For purposes of this paragraph , a corporation shall be treated as a qualified leasing member for the taxable year only if for each of the taxable years referred to in subparagraph (B) -

(i) it is a component member of the controlled group of corporations, and

(ii) it meets the requirements of paragraph (4)(B) (as modified by subparagraph (A)(i) of this paragraph ).

(6) Definitions relating to paragraphs (4) and (5) .

For purposes of paragraphs (4) and (5) -

(A) Equipment leasing. The term "equipment leasing" means-

(i) the leasing of equipment which is section 1245 property, and

(ii) the purchasing, servicing, and selling of such equipment.

(B) Leasing of master sound recordings, etc., excluded. The term "equipment leasing" does not include the leasing of master sound recordings, and other similar contractual arrangements with respect to tangible or intangible assets associated with literary, artistic, or musical properties.

(C) Controlled group of corporations; component member. The terms "controlled group of corporations" and "component member" have the same meanings as when used in section 1563 . The determination of the taxable years taken into account with respect to any controlled group of corporations shall be made in a manner consistent with the manner set forth in section 1563 .

(7) Exclusion of active businesses of qualified C corporations.

- (A) In general. In the case of a taxpayer which is a qualified C corporation-
- (i) each qualifying business carried on by such taxpayer shall be treated as a separate activity, and
  - (ii) subsection (a) shall not apply to losses from such business.

(B) Qualified C corporation. For purposes of subparagraph (A) , the term "qualified C corporation" means any corporation described in subparagraph (B) of subsection (a)(1) which is not-

- (i) a personal holding company (as defined in section 542(a) ), or
- (ii) a personal service corporation (as defined in section 269A(b) but determined by substituting "5 percent" for "10 percent" in section 269A(b)(2) ).

(C) Qualifying business. For purposes of this paragraph , the term "qualifying business" means any active business if-

- (i) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 1 full-time employee substantially all the services of whom were in the active management of such business,
- (ii) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 3 full-time, nonowner employees substantially all of the services of whom were services directly related to such business,
- (iii) the amount of the deductions attributable to such business which are allowable to the taxpayer solely by reason of sections 162 and 404 for the taxable year exceeds 15 percent of the gross income from such business for such year, and
- (iv) such business is not an excluded business.

(D) Special rules for application of subparagraph (C) .

- (i) Partnerships in which taxpayer is a qualified corporate partner. In the case of an active business of a partnership, if-
  - (I) the taxpayer is a qualified corporate partner in the partnership, and
  - (II) during the entire 12-month period ending on the last day of the partnership's taxable year, there was at least 1 full-time employee of the partnership (or of a qualified corporate partner) substantially all the services of whom were in the active management of such business,

then the taxpayer's proportionate share (determined on the basis of its profits interest) of the activities of the partnership in such business shall be treated as activities of the taxpayer (and clause (i) of subparagraph (C)

shall not apply in determining whether such business is a qualifying business of the taxpayer).

(ii) Qualified corporate partner. For purposes of clause (i) , the term "qualified corporate partner" means any corporation if-

(I) such corporation is a general partner in the partnership,

(II) such corporation has an interest of 10 percent or more in the profits and losses of the partnership, and

(III) such corporation has contributed property to the partnership in an amount not less than the lesser of \$500,000 or 10 percent of the net worth of the corporation.

For purposes of subclause (III) , any contribution of property other than money shall be taken into account at its fair market value.

(iii) Deduction for owner employee compensation not taken into account. For purposes of clause (iii) of subparagraph (C) , there shall not be taken into account any deduction in respect of compensation for personal services rendered by any employee (other than a non-owner employee) of the taxpayer or any member of such employee's family (within the meaning of section 318(a)(1) ).

(iv) Special rule for banks. For purposes of clause (iii) of subparagraph (C) , in the case of a bank (as defined in section 581 ) or a financial institution to which section 591 applies-

(I) gross income shall be determined without regard to the exclusion of interest from gross income under section 103 , and

(II) in addition to the deductions described in such clause, there shall also be taken into account the amount of the deductions which are allowable for amounts paid or credited to the accounts of depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts under section 163 or 591 .

(v) Special rule for life insurance companies.

(I) In general. Clause (iii) of subparagraph (C) shall not apply to any insurance business of a qualified life insurance company.

(II) Insurance business. For purposes of subclause (I) , the term "insurance business" means any business which is not a noninsurance business (within the meaning of section 453B(e)(3) ).

(III) Qualified life insurance company. For purposes of subclause (I) , the term "qualified life insurance company" means any company which would be a life insurance company as defined in section 816 if unearned premiums were not taken into account under subsections (a)(2) and (c)(2) of section 816 .



(E) Definitions. For purposes of this paragraph -

(i) Non-owner employee. The term "non-owner employee" means any employee who does not own, at any time during the taxable year, more than 5 percent in value of the outstanding stock of the taxpayer. For purposes of the preceding sentence, section 318 shall apply, except that "5 percent" shall be substituted for "50 percent" in section 318(a)(2)(C) .

(ii) Excluded business. The term "excluded business" means-

(I) equipment leasing (as defined in paragraph (6) ), and

(II) any business involving the use, exploitation, sale, lease, or other disposition of master sound recordings, motion picture films, video tapes, or tangible or intangible assets associated with literary, artistic, musical, or similar properties.

(iii) Special rules relating to communications industry, etc.

(I) Business not excluded where taxpayer not completely at risk. A business involving the use, exploitation, sale, lease, or other disposition of property described in subclause (II) of clause (ii) shall not constitute an excluded business by reason of such subclause if the taxpayer is at risk with respect to all amounts paid or incurred (or chargeable to capital account) in such business.

(II) Certain licensed businesses not excluded. For purposes of subclause (II) of clause (ii) , the provision of radio, television, cable television, or similar services pursuant to a license or franchise granted by the Federal Communications Commission or any other Federal, State, or local authority shall not constitute an excluded business by reason of such subclause.

(F) Affiliated group treated as 1 taxpayer. For purposes of this paragraph -

(i) In general. Except as provided in subparagraph (G) , the component members of an affiliated group of corporations shall be treated as a single taxpayer.

(ii) Affiliated group of corporations. The term "affiliated group of corporations" means an affiliated group (as defined in section 1504(a) ) which files or is required to file consolidated income tax returns.

(iii) Component member. The term "component member" means an includible corporation (as defined in section 1504 ) which is a member of the affiliated group.

(G) Loss of 1 member of affiliated group may not offset income of personal holding company or personal service corporation. Nothing in this paragraph shall permit any loss of a member of an affiliated group to be used as an offset against the income of any other member of such group which is a personal holding company (as defined in section 542(a) ) or a personal service corporation (as defined in section 269A(b) but determined by substituting "5 percent" for "10 percent" in section 269A(b)(2) ).

(d) Definition of loss.

For purposes of this section , the term "loss" means the excess of the deductions allowable under this chapter for the taxable year (determined without regard to the first sentence of subsection (a) ) and allocable to an activity to which this section applies over the income received or accrued by the taxpayer during the taxable year from such activity (determined without regard to subsection (e)(1)(A) ).

(e) Recapture of losses where amount at risk is less than zero.

(1) In general.

If zero exceeds the amount for which the taxpayer is at risk in any activity at the close of any taxable year-

(A) the taxpayer shall include in his gross income for such taxable year (as income from such activity) an amount equal to such excess, and

(B) an amount equal to the amount so included in gross income shall be treated as a deduction allocable to such activity for the first succeeding taxable year.

(2) Limitation.

The excess referred to in paragraph (1) shall not exceed-

(A) the aggregate amount of the reductions required by subsection (b)(5) with respect to the activity by reason of losses for all prior taxable years beginning after December 31, 1978, reduced by

(B) the amounts previously included in gross income with respect to such activity under this subsection .