

Reg. Section 1.183-1(b)

Activities not engaged in for profit

(b) Deductions allowable—

(1) Manner and extent. If an activity is not engaged in for profit, deductions are allowable under section 183(b) in the following order and only to the following extent:

- (i) Amounts allowable as deductions during the taxable year under Chapter 1 of the Code without regard to whether the activity giving rise to such amounts was engaged in for profit are allowable to the full extent allowed by the relevant sections of the Code, determined after taking into account any limitations or exceptions with respect to the allowability of such amounts. For example, the allowability-of-interest expenses incurred with respect to activities not engaged in for profit is limited by the rules contained in section 163(d).
- (ii) Amounts otherwise allowable as deductions during the taxable year under Chapter 1 of the Code, but only if such allowance does not result in an adjustment to the basis of property, determined as if the activity giving rise to such amounts was engaged in for profit, are allowed only to the extent the gross income attributable to such activity exceeds the deductions allowed or allowable under subdivision (i) of this subparagraph.
- (iii) Amounts otherwise allowable as deductions for the taxable year under Chapter 1 of the Code which result in (or if otherwise allowed would have resulted in) an adjustment to the basis of property, determined as if the activity giving rise to such deductions was engaged in for profit, are allowed only to the extent the gross income attributable to such activity exceeds the deductions allowed or allowable under subdivisions (i) and (ii) of this subparagraph. Deductions falling within this subdivision include such items as depreciation, partial losses with respect to property, partially worthless debts, amortization, and amortizable bond premium.

(2) Rule for deductions involving basis adjustments—

- (i) In general. If deductions are allowed under subparagraph (1)(iii) of this paragraph, and such deductions are allowed with respect to more than one asset, the deduction allowed with respect to each asset shall be

determined separately in accordance with the computation set forth in subdivision (ii) of this subparagraph.

(ii) **Basis adjustment fraction.** The deduction allowed under subparagraph (1)(iii) of this paragraph is computed by multiplying the amount which would have been allowed, had the activity been engaged in for profit, as a deduction with respect to each particular asset which involves a basis adjustment, by the basis adjustment fraction:

- (a) The numerator of which is the total of deductions allowable under subparagraph (1)(iii) of this paragraph, and
- (b) The denominator of which is the total of deductions which involve basis adjustments which would have been allowed with respect to the activity had the activity been engaged in for profit.

The amount resulting from this computation is the deduction allowed under subparagraph (1)(iii) of this paragraph with respect to the particular asset. The basis of such asset is adjusted only to the extent of such deduction.

(3) **Examples.** The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example 1. A, an individual, maintains a herd of dairy cattle, which is an “activity not engaged in for profit” within the meaning of section 183(c). A sold milk for \$1,000 during the year. During the year A paid \$300 State taxes on gasoline used to transport the cows, milk, etc., and paid \$1,200 for feed for the cows. For the year A also had a casualty loss attributable to this activity of \$500. A determines the amount of his allowable deductions under section 183 as follows:

(i) First, A computes his deductions allowable under subparagraph (1)(i) of this paragraph as follows:

State gasoline taxes specifically allowed under section 164(a)(5) without regard to whether the activity is engaged in for profit	\$300
Casualty loss specifically allowed under section 165(c)(3) without regard to whether the activity is engaged in for profit (\$500 less \$100 limitation)	400
Deductions allowable under subparagraph (1)(i) of this paragraph	700

(ii) Second, A computes his deductions allowable under subparagraph (1)(ii) of this paragraph (deductions which would be allowed under chapter 1 of the Code if the activity were engaged in for profit and which do not involve basis adjustments) as follows:

Maximum amount of deductions allowable under subparagraph (1)(ii) of this paragraph:

Income from milk sales	\$1,000
Gross income from activity	1,000
Less: deductions allowable under subparagraph (1)(i) of this paragraph	700
Maximum amount of deductions allowable under subparagraph (1)(ii) of this paragraph	300
Feed for cows	1,200
Deduction allowed under subparagraph (1)(ii) of this paragraph	300

\$900 of the feed expense is not allowed as a deduction under section 183 because the total feed expense (\$1,200) exceeds the maximum amount of deductions allowable under subparagraph (1)(ii) of this paragraph (\$300). In view of these circumstances, it is not necessary to determine deductions allowable under subparagraph (1)(iii) of this paragraph which would be allowable under chapter 1 of the Code if the activity were engaged in for profit and which involve basis adjustment (the \$100 of casualty loss not allowable under subparagraph (1)(i) of this paragraph because of the limitation in section 165(c)(3)) because none of such amount will be allowed as a deduction under section 183.

Example 2. Assume the same facts as in Example 1, except that A also had income from sales of hay grown on the farm of \$1,200 and that depreciation of \$750 with respect to a barn, and \$650 with respect to a tractor would have been allowed with respect to the activity had it been engaged in for profit. A determines the amount of his allowable deductions under section 183 as follows:

(i) First, A computes his deductions allowable under subparagraph (1)(i) of this paragraph as follows:

State gasoline taxes specifically allowed under section 164(a)(5) without regard to whether the activity is engaged in for profit	\$300
Casualty loss specifically allowed under section 165(c)(3) without regard to whether the activity is engaged in for profit (\$500 less \$100 limitation)	400
Deductions allowable under subparagraph (1)(i) of this paragraph	700

(ii) Second, A computes his deductions allowable under subparagraph (1)(ii) of this paragraph (deductions which would be allowable under chapter 1 of the Code if the activity were engaged in for profit and which do not involve basis adjustments) as follows:

Maximum amount of deductions allowable under subparagraph (1)(ii) of this paragraph:

Income from milk sales	\$1,000
Income from hay sales	1,200
Gross income from activity	2,200
Less: deductions allowable under subparagraph (1)(i) of this paragraph	700
Maximum amount of deductions allowable under subparagraph (1)(ii) of this paragraph	1,500
Feed for cows	1,200

The entire \$1,200 of expenses relating to feed for cows is allowable as a deduction under subparagraph (1)(ii) of this paragraph, since it does not exceed the maximum amount of deductions allowable under such subparagraph.

(iii) Last, A computes the deductions allowable under subparagraph (1)(iii) of this paragraph (deductions which would be allowable under chapter 1 of the Code if the activity were engaged in for profit and which involve basis adjustments) as follows:

Maximum amount of deductions allowable under subparagraph (1)(iii) of this paragraph:

Gross income from farming	\$2,200
Less: Deductions allowed under subparagraph (1)(i) of this paragraph	\$700
Deductions allowed under subparagraph (1)(ii) of this paragraph	1,200
Maximum amount of deductions allowable under subparagraph (1)(iii) of this paragraph	300

(iv) Since the total of A's deductions under chapter 1 of the Code (determined as if the activity was engaged in for profit) which involve basis adjustments (\$750 with respect to barn, \$650 with respect to tractor, and \$100 with respect to limitation on casualty loss) exceeds the maximum amount of the deductions allowable under subparagraph (1)(iii) of this paragraph (\$300), A computes his allowable deductions with respect to such assets as follows:

A first computes his basis adjustment fraction under subparagraph (2)(ii) of this paragraph as follows:

The numerator of the fraction is the maximum of deductions allowable under subparagraph (1)(iii) of this paragraph which involve basis adjustments	\$300
--	-------

The denominator of the fraction is the total of deductions that involve basis adjustments which would have been allowed with respect to the activity had the activity been engaged in for profit 1,500

The basis adjustment fraction is then applied to the amount of each deduction which would have been allowable if the activity were engaged in for profit and which involves a basis adjustment as follows:

Depreciation allowed with respect to barn $(300/1,500 \times \$750)$	\$150
Depreciation allowed with respect to tractor $(300/1,500 \times \$650)$	130
Deduction allowed with respect to limitation on casualty loss $(300/1,500 \times \$100)$	20

The basis of the barn and of the tractor are adjusted only by the amount of depreciation actually allowed under section 183 with respect to each (as determined by the above computation). The basis of the asset with regard to which the casualty loss was suffered is adjusted only to the extent of the amount of the casualty loss actually allowed as a deduction under subparagraph (1)(i) and (iii) of this paragraph.

(4) Rule for capital gains and losses--(i) In general. For purposes of section 183 and the regulations thereunder, the gross income from any activity not engaged in for profit includes the total of all capital gains attributable to such activity determined without regard to the section 1202 deduction. Amounts attributable to an activity not engaged in for profit which would be allowable as a deduction under section 1202, without regard to section 183, shall be allowable as a deduction under section 183(b)(1) in accordance with the rules stated in this subparagraph.

(ii) Cases where deduction not allowed under section 183. No deduction is allowable under section 183(b)(1) with respect to capital gains attributable to an activity not engaged in for profit if:

- (a) Without regard to section 183 and the regulations thereunder, there is no excess of net long-term capital gain over net short-term capital loss for the year, or
- (b) There is no excess of net long-term capital gain attributable to the activity over net short-term capital loss attributable to the activity.

(iii) Allocation of deduction. If there is:

- (a) An excess of net long-term capital gain over net short-term capital loss attributable to an activity not engaged in for profit, and
- (b) Such an excess attributable to all activities, determined without regard to section 183 and the regulations thereunder, the deduction allowable under section 183(b)(1) attributable to capital gains with respect to each activity not engaged in for profit (with respect to which there is an excess of net long-term capital gain over net short-term capital loss for the year) shall be an

amount equal to the deduction allowable under section 1202 for the taxable year (determined without regard to section 183) multiplied by a fraction the numerator of which is the excess of the net long-term capital gain attributable to the activity over the net short-term capital loss attributable to the activity and the denominator of which is an amount equal to the total excess of net long-term capital gain over net short-term capital loss for all activities with respect to which there is such excess. The amount of the total section 1202 deduction allowable for the year shall be reduced by the amount determined to be allocable to activities not engaged in for profit and accordingly allowed as a deduction under section 183(b)(1).

(iv) Example. The provisions of this subparagraph may be illustrated by the following example:

Example. A, an individual who uses the cash receipts and disbursement method of accounting and the calendar year as the taxable year, has three activities not engaged in for profit. For his taxable year ending on December 31, 1973, A has a \$200 net long-term capital gain from activity No. 1, a \$100 net short-term capital loss from activity No. 2, and a \$300 net long-term capital gain from activity No. 3. In addition, A has a \$500 net long-term capital gain from another activity which he engages in for profit. A computes his deductions for capital gains for calendar year 1973 as follows:

Section 1202 deduction without regard to section 183 is determined as follows:

Net long-term capital gain from activity No. 1	\$200
Net long-term capital gain from activity No. 3	300
Net long-term capital gain from activity engaged in for profit	500
Total net long-term capital gain from all activities	1,000
Less: Net short-term capital loss attributable to activity No. 2	100
Aggregate net long-term capital gain over net short-term capital loss from all activities	900
Section 1202 deduction determined without regard to section 183 (one-half of \$900)	\$450

Allocation of the total section 1202 deduction among A's various activities:

Portion allocable to activity No. 1 which is deductible under section 183(b)(1) (Excess net long-term capital gain attributable to activity No. 1 (\$200) over total excess net long-term capital gain attributable to all of A's activities with respect to which there is such an excess (\$1,000) times amount of section 1202 deduction (\$450))	90
Portion allocable to activity No. 3 which is deductible under section 183(b)(1) (Excess net long-term capital gain attributable to activity No. 3 (\$300) over total excess net long-term capital gain attributable to all of	135

A's activities with respect to which there is such an excess (\$1,000)
times amount of section 1202 deduction (\$450)

Portion allocable to all activities engaged in for profit (total section 1202 deduction (\$450) less section 1202 deduction allowable to activities Nos. 1 and 3 (\$225))	225
---	-----

Total section 1202 deduction deductible under sections 1202 and 183(b)(1)	450
---	-----

...