

Reg. Section 1.469-1T(g)(3)

General rules (temporary).

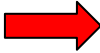
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(g) Application of these rules to C corporations -- (1) In general. Except as otherwise provided in the rules to be contained in paragraph (k) of this section, section 469 and the regulations thereunder do not apply to any corporation that is not a personal service corporation or a closely held corporation for the taxable year. See paragraphs (g) (4) and (5) of this section for special rules for computing the passive activity loss and passive activity credit, respectively, of a closely held corporation.

(2) Definitions. For purposes of section 469 and the regulations thereunder --

(i) The term personal service corporation means a C corporation that is a personal service corporation for the taxable year (within the meaning of § 1.441-3(c)); and

(ii) The term closely held corporation means a C corporation that meets the stock ownership requirements of section 542(a)(2) (taking into account the modifications in section 465(a)(3)) for the taxable year and is not a personal service corporation for such year.

 (3) Participation of corporations -- (i) Material participation. For purposes of section 469 and the regulations thereunder, a corporation described in paragraph (g)(2) of this section shall be treated as materially participating in an activity for a taxable year if and only if --

(A) One or more individuals, each of whom is treated under paragraph (g)(3)(iii) of this section as materially participating in such activity for the taxable year, directly or indirectly hold (in the aggregate) more than 50 percent (by value) of the outstanding stock of such corporation; or

(B) In the case of a closely held corporation (within the meaning of paragraph (g)(2)(ii) of this section), the requirements of section 465(c)(7)(C) (without regard to clause (iv) thereof and taking into account section 465(c)(7)(D)) are met with respect to such activity.

(ii) Significant participation. For purposes of § 1.469-2T(f)(2), an activity of a corporation described in paragraph (g)(2) of this section shall be treated as a significant participation passive activity for a taxable year if and only if --

(A) The corporation is not treated as materially participating in such activity for the taxable year; and

(B) One or more individuals, each of whom is treated under paragraph (g)(3)(iii) of this section as significantly participating in such activity, directly or indirectly hold (in the aggregate) more than 50 percent (by value) of the outstanding stock of such corporation.

(iii) Participation of individual. Whether an individual is treated for purposes of this paragraph (g)(3) as materially participating or significantly participating in an activity of a corporation shall be determined under the rules of § 1.469-5T, except that in applying such rules --

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(A) All activities of the corporation shall be treated as activities in which the individual holds an interest in determining whether the individual participates (within the meaning of § 1.469-5T(f)) in an activity of the corporation; and

(B) The individual's participation in all activities other than activities of the corporation shall be disregarded in determining whether the individual's participation in an activity of the corporation is treated as material participation under § 1.469-5T(a)(4) (relating to material participation in significant participation activities).

(4) Modified computation of passive activity loss in the case of closely held corporations. --
(i) In general. A closely held corporation's passive activity loss for the taxable year is the amount, if any, by which the corporation's passive activity deductions for the taxable year (within the meaning of § 1.469-2T(d)) exceed the sum of --

(A) The corporation's passive activity gross income for the taxable year (within the meaning of § 1.469-2T(c)); and

(B) The corporation's net active income for the taxable year.

(ii) Net active income. For purposes of this paragraph (g)(4), a corporation's net active income for the taxable year is such corporation's taxable income for the taxable year, determined without regard to the following items for the year:

(A) Passive activity gross income;

(B) Passive activity deductions;

(C) [Reserved] See § 1.469-1(g)(4)(ii)(C) for rules relating to this paragraph.

(D) Gross income that is treated under § 1.469-2T(c)(6) (relating to gross income from certain oil or gas properties) as not from a passive activity;

(E) Gross income and deductions from any trade or business activity (within the meaning of paragraph (e)(2) of this section) that is described in paragraph (e)(6) of this section (relating to certain activities of trading personal property) but only if the corporation did not materially participate in such activity for the taxable year;

(F) Deductions described in § 1.469-2T(d)(2)(i), (ii), and (iv) (relating to certain deductions attributable to portfolio income); and

(G) Interest expense allocated under § 1.163-8T to a portfolio expenditure (within the meaning of § 1.163-8T(b)(6)).

(iii) Examples. The following examples illustrate the application of this paragraph (g)(4):

Example (1). (i) For 1987, X, a closely held corporation, is engaged in two activities, a trade or business activity in which X materially participates for 1987 and a rental activity. X also holds portfolio investments. For 1987, X has the following gross income and deductions:

Gross income:

Rents	\$ 60,000
Gross income from business	100,000
Portfolio income	35,000
Total	\$ 195,000

Deductions:	
Rental deductions	(\$ 100,000)
Business deductions (80,000)	
Interest expense allocable to portfolio expenditures under § 1.163-8T	(10,000)
Deductions (other than interest expense) clearly and directly allocable to portfolio income	(5,000)
Total	(\$ 195,000)

(ii) The corporation's net active income for 1987 is \$ 20,000, computed as follows:

Gross income		\$ 195,000	
Amounts not taken into account in computing net active income:			
Rents (see paragraph (g)(4)(ii)(A) of this section)	\$ 60,000		
Portfolio income (see paragraph (g)(4)(ii)(C) of this section)	\$ 35,000		
	\$ 95,000	(\$ 95,000)	
Gross income taken into account in computing net active income		\$ 100,000	\$ 100,000
Deductions		(\$ 195,000)	
Amounts not taken into account in computing net active income:			
Rental deductions (see paragraph (g)(4)(ii)(B) of this section)	(\$ 100,000)		
Interest expense allocated to portfolio expenditures (see paragraph (g)(4)(ii)(G) of this section)	(\$ 10,000)		
Other deductions clearly and directly allocable to portfolio income (see paragraph (g)(4)(ii)(F) of this section)	(\$ 5,000)		
	(\$ 115,000)	\$ 115,000	
Deductions taken into account in computing net active income		(\$ 80,000)	(\$ 80,000)
Net active income			\$ 20,000

(iii) Under paragraph(g)(4)(i) of this section, X's passive activity loss for 1987 is \$ 20,000, the amount by which the passive activity deductions for the taxable year (\$ 100,000) exceed the sum of (a) the passive activity gross income for the taxable year (\$ 60,000) and (b) the net active income for the taxable year (\$ 20,000). Under paragraph (f)(4) of this section, the \$ 20,000 of deductions from X's rental activity that are disallowed for 1987 are treated as deductions from the rental activity for 1988. If computed without regard to the net active income for the taxable year, X's passive activity loss would be \$ 40,000 (\$ 100,000 of rental deductions minus \$ 60,000 of rental income). Thus, the effect of the rule in paragraph (g)(4)(i) of this section is to reduce the corporation's passive activity loss for the taxable year by the amount of the corporation's net active income for such year.

(iv) Under these facts, X's taxable income for 1987 is \$ 20,000, computed as follows:

Gross income		\$ 195,000
Deductions:		
Total deductions	(\$ 195,000)	
Passive activity loss	\$ 20,000	
Allowable deductions	(\$ 175,000)	(\$ 175,000)
Taxable income		\$ 20,000

Example (2). (i) The facts are the same as in example (1), except that, in 1988, X has a loss from the trade or business activity, and a net operating loss ("NOL") of \$ 15,000 that is carried back under section 172(b) to 1987. Since NOL carrybacks are taken into account in computing net active income, X's net active income for 1987 must be recomputed as follows:

Net active income before NOL carryback	\$ 20,000
NOL carryback	(\$ 15,000)
Net active income	\$ 5,000

(ii) Under these facts, X's disallowed passive activity loss for 1987 is \$ 35,000, the amount by which the passive activity deductions for the taxable year (\$ 100,000) exceed the sum of (a) the passive activity gross income for the taxable year (\$ 60,000) and (b) the net active income for the taxable year (\$ 5,000).

(iii) Under paragraph (f)(4) of this section, the \$ 35,000 of deductions from X's rental activity that are disallowed for 1987 are treated as deductions from the rental activity for 1988. X's taxable income for 1987 is \$ 20,000, computed as follows:

Gross income		\$ 195,000
Deductions:		
Total deductions	(\$ 210,000)	
Passive activity loss	\$ 35,000	

Allowable deductions	(\$ 175,000)	(\$ 175,000)
Taxable income		\$ 20,000

Thus, taking the NOL carryback into account in computing net active income for 1987 does not affect X's taxable income for 1987, but increases the deductions treated under paragraph (f)(4) as deductions from X's rental activity for 1988 and decreases X's NOL carryover to years other than 1987.

(5) Allowance of passive activity credit of closely held corporations to extent of net active income tax liability -- (i) In general. Solely for purposes of determining the amount disallowed under paragraph (a)(1)(ii) of this section, a closely held corporation's passive activity credit for the taxable year shall be reduced by such corporation's net active income tax liability for such year.

(ii) Net active income tax liability. For purposes of paragraph (g)(5)(i) of this section, a corporation's net active income tax liability for a taxable year is the amount (if any) by which --

(A) The corporation's regular tax liability (within the meaning of section 26(b)) for the taxable year, determined by reducing the corporation's taxable income for such year by an amount equal to the excess (if any) of the corporation's passive activity gross income for such year over the corporation's passive activity deductions for such year; exceeds

(B) The sum of --

(1) The corporation's regular tax liability for the taxable year, determined by reducing the corporation's taxable income for such year by an amount equal to the excess (if any) of the sum of the corporation's net active income (within the meaning of paragraph (g)(4)(ii) of this section) and passive activity gross income for such year over the corporation's passive activity deductions for such year; and

(2) The corporation's credits (other than credits from passive activities) that are allowable for the taxable year (without regard to the limitations contained in sections 26(a), 28(d)(2), 29(b)(5), 38(c), and 469).

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