



# Instructions for Form 8810

## Corporate Passive Activity Loss and Credit Limitations

Section references are to the Internal Revenue Code unless otherwise noted.

### Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

**Recordkeeping** . . . . . 26 hr., 19 min.

**Learning about the law or the form** . . . . . 5 hr., 22 min.

**Preparing and sending the form to the IRS** . . . . . 6 hr., 2 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to both the IRS and the Office of Management and Budget at the addresses listed in the instructions for the tax return with which this form is filed.

### General Instructions

#### Changes To Note

- For tax years beginning after 1993, a closely held corporation that derives more than 50% of its gross receipts from real property trades or businesses in which it materially participates is not subject to the passive activity limitations on losses or credits from rental real estate activities in which it materially participates. For details, see item 2 under **Activities That Are Not Passive Activities** on page 2.
- Final regulations defining the term “activity” have been issued. See **Grouping the Corporation’s Activities** on page 4 for details.
- New **Part III**, Election To Increase Basis of Credit Property, must be completed if the corporation disposed of its entire interest in a passive activity (or former passive activity) and it elects to increase the basis of credit property used in the activity by the unallowed credit that reduced the property’s basis.

### Purpose of Form

Form 8810 is used by closely held corporations and personal service corporations to figure the amount of any passive activity loss or credit for the current tax year and the amount of losses and credits from passive activities allowed on the corporation’s tax return.

A personal service corporation has a passive activity loss for the year if the total losses (including prior year unallowed losses) from all its passive activities exceed the total income from all of its passive activities. A closely held corporation has a passive activity loss for the year if the total losses (including prior year unallowed losses) from all its passive activities exceed the sum of the total income from all its passive activities and its net active income.

A personal service corporation has a passive activity credit for the year if its credits from passive activities (including prior year unallowed credits) exceed the tax attributable to net passive income. A closely held corporation has a passive activity credit for the year if its credits from passive activities (including prior year unallowed credits) exceed the sum of the tax attributable to net passive income and the tax attributable to net active income.

Generally, passive activities include trade or business activities in which the corporation did not materially participate for the tax year, and rental activities regardless of its participation.

For more information, get **Pub. 925**, *Passive Activity and At-Risk Rules*.

### Who Must File

Personal service corporations and closely held corporations that have losses or credits from passive activities must file Form 8810. A “personal service corporation” is a corporation (other than an S corporation) that is a personal service corporation for the tax year (as defined in Temporary Regulations section 1.441-4T(d)). A “closely held corporation” is a corporation (other than an S corporation) that meets the stock ownership requirements of section 542(a)(2) (as modified by section 465(a)(3)) for the tax year and is not a personal service corporation for the tax year.

### Definitions

Except as otherwise indicated, the following terms are defined as shown below.

**Net income** means the excess of current year income over current year deductions from the activity. This includes any current year gains or losses from the disposition of assets or an interest in the activity.

**Net loss** means the excess of current year deductions over current year income from the activity. This includes any current year gains or losses from the disposition of assets or an interest in the activity.

**Overall gain** means the excess of the “net income” from the activity over the prior year unallowed losses from the activity.

**Overall loss** means the excess of the prior year unallowed losses from the activity over the “net income” from the activity or the prior year unallowed losses from the activity plus the “net loss” from the activity.

**Prior year unallowed losses** means the deductions and losses from an activity that were disallowed under the passive activity loss limitations in a prior year and carried forward to this tax year under section 469(b). See Regulations section 1.469-1(f)(4).

### Coordination With Other Limitations

Losses from passive activities generally are subject to other applicable limitations (e.g., basis and at-risk limitations) before they are subject to the passive loss limitations. Once a loss becomes allowable under these other limitations, the corporation must determine whether the loss is limited under the passive loss rules. See **Form 6198**, *At-Risk Limitations*, for details on the at-risk rules. Capital losses that are allowable under the passive loss rules, however, may be limited under section 1211(a). Similarly, percentage depletion deductions that are allowable under the passive loss rules may be limited under section 613A(d).

## Special Rules for Consolidated Group

The passive activity loss and passive activity credit of an affiliated group of corporations filing a consolidated return for the tax year (a consolidated group) are determined by taking into account the following items of each member of the group.

- Passive activity gross income and deductions; and
- Gain or loss on dispositions; and
- Net active income (for a consolidated group treated as a closely held corporation); and
- Credits from passive activities.

## Activities That Are Not Passive Activities

The following are not passive activities:

1. Trade or business activities in which the corporation materially participated for the tax year.
2. For tax years beginning after 1993, any rental real estate activity in which the corporation materially participated if the corporation was a closely held corporation that derived more than 50% of its gross receipts from real property trades or businesses in which it materially participated.

For purposes of this rule, each interest is a separate activity, unless the corporation elects to treat all interests in rental real estate as one activity.

A real property trade or business is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

**Note:** *If an activity qualifies for the exception described above in 1994, but has a prior year unallowed loss, the prior year unallowed loss is treated as a loss from a former passive activity. See Former Passive Activities on page 5.*

3. An interest in an oil or gas well drilled or operated under a working interest if at any time during the tax year the corporation held the working interest directly or through an entity that did not limit the corporation's liability (such as a general partner interest in a partnership). This exception applies regardless of whether the corporation materially participated in the activity for the tax year.

If, however, the corporation's liability was not unlimited for the entire year (e.g., the corporation converted its general partner interest to a limited partner interest during the year), some of the corporation's income and losses from the working interest may be treated as passive activity gross income and passive activity deductions. See Temporary Regulations section 1.469-1T(e)(4)(ii).

4. An activity of trading personal property for the account of owners of interests in the activity. See Temporary Regulations section 1.469-1T(e)(6).

Generally, income, losses, and credits from these activities should not be entered on Form 8810. However, losses and credits from these activities may be subject to limitations other than the passive loss and credit rules.

## Rental Activities

A rental activity is a passive activity even if the corporation materially participated in the activity (other than a rental real estate activity in which the corporation materially participated, if the corporation was a closely held corporation that derived more than 50% of its gross receipts from real property trades or businesses in which it materially participated).

An activity is a rental activity if tangible property (real or personal) is used by customers or held for use by customers, and the gross income (or expected gross income) from the activity represents amounts paid (or to be paid) mainly for the use of the property, regardless of whether the use is under a lease, a service contract, or some other arrangement that is not called a lease.

However, if the corporation meets any one of the six exceptions listed below, the rental of the property is not treated as a rental activity. See **Reporting Income, Deductions, Losses, and Credits From the Activities** on page 3 if the corporation meets any of the exceptions.

### Exceptions

An activity is not a rental activity if:

1. The average period of customer use of the rental property is 7 days or less.

Figure the **average period of customer use** for a class of property by dividing the total number of days in all rental periods by the number of rentals during the tax year. If the activity involves renting more than one class of property, multiply the average period of customer use of each class by the ratio of the gross rental income from that class to the activity's total gross rental income. The activity's average period of customer use equals the sum of these class-by-class average periods weighted by gross income. See Regulations section 1.469-1(e)(3)(iii).

2. The average period of customer use (defined above) of the rental property is 30 days or less and significant personal services were provided in connection with making the rental property available for customer use.

**Significant personal services** include only services performed by individuals. In determining whether personal services are significant, all the relevant facts and circumstances are taken into

consideration. Facts and circumstances include the frequency of the services, the type and amount of labor required to perform the services, and the value of the services relative to the amount charged for the use of the property.

Significant personal services do not include excluded services. See Temporary Regulations section 1.469-1T(e)(3)(iv)(B).

3. Extraordinary personal services were provided in connection with making the rental property available for customer use.

Services provided in connection with making rental property available for customer use are **extraordinary personal services** only if the services are performed by individuals and the customers' use of the rental property is incidental to their receipt of the services.

4. The rental of the property is incidental to a nonrental activity.

The rental of property is incidental to an activity of holding property for investment if the main purpose for holding the property is to realize a gain from the appreciation of the property and the gross rental income is less than 2% of the smaller of the unadjusted basis of the property or the fair market value of the property.

**Unadjusted basis** means the cost of the property without regard to depreciation deductions or any other adjustment described in section 1016 that reduces basis.

The rental of property is incidental to a trade or business activity if:

- a. The corporation owned an interest in the trade or business activity during the year;
- b. The rental property was mainly used in the trade or business activity during the tax year or during at least 2 of the 5 preceding tax years; and
- c. The gross rental income from the property is less than 2% of the smaller of the unadjusted basis of the property or the fair market value of the property.

Lodging provided for the employer's convenience to an employee or the employee's spouse or dependents is incidental to the activity or activities in which the employee performs services.

5. The corporation customarily makes the rental property available during defined business hours for nonexclusive use by various customers.

6. The corporation provides property for use in a nonrental activity of a partnership or joint venture in its capacity as an owner of an interest in such partnership or joint venture.

For example, if a partner contributes the use of property to a partnership, none of the partner's distributive share of partnership income is income from a rental activity unless the partnership is engaged in a rental activity. In addition,

a partner's gross income attributable to a guaranteed payment under section 707(c) is not income from a rental activity. The determination of whether the property used in the activity is provided in the partner's capacity as an owner of an interest in the partnership is made on the basis of all the facts and circumstances.

### Reporting Income, Deductions, Losses, and Credits From the Activities

If the corporation meets any of the six exceptions listed above, the corporation's rental of the property is not a rental activity. The corporation then must determine whether the rental of the property is a trade or business activity and, if so, whether the corporation materially participated or significantly participated in the activity for the tax year. (See **Trade or Business Activities and Material or Significant Participation** below.) To report income, deductions, losses, or credits from a trade or business activity in which the corporation did not materially participate, see **Trade or business activities without material participation** below.

If the corporation meets any of the six exceptions listed above and the activity is a trade or business activity in which the corporation materially participated, report any income, deduction, loss, or credit from the activity on the forms or schedules normally used.

If the corporation **did not** meet any of the six exceptions, the rental activity is generally a passive activity. Special rules apply if the corporation conducted the rental activity through a publicly traded partnership (PTP) or if any of the rules described in **Recharacterization of Passive Income** on page 5 apply. See **Publicly Traded Partnerships (PTPs)** on page 10.

If none of the special rules apply, use Worksheets 1 and 2 on page 7 to determine the amount to enter in Part I of Form 8810 for each passive rental activity. If the corporation has credits from passive rental activities, use Worksheet 5 on page 11 to figure the amount to enter in Part II of Form 8810.

### Trade or Business Activities

A trade or business activity is an activity (other than a rental activity or an activity treated as incidental to an activity of holding property for investment) that:

1. Involves the conduct of a trade or business (within the meaning of section 162),
2. Is conducted in anticipation of starting a trade or business, or
3. Involves research or experimental expenditures deductible under section 174 (or that would be if the corporation

chose to deduct rather than capitalize them).

### Reporting Income, Deductions, Losses, and Credits From the Activities

**Trade or business activities with material participation.**—If the corporation materially participated in a trade or business activity, the activity is not a passive activity. Report the income, deductions, losses, and credits from the activity on the form or schedule normally used.

**Trade or business activities without material participation.**—In general, use Worksheets 1 and 2 on page 7 to determine the amount to enter in Part I of Form 8810 for each trade or business activity in which the corporation did not materially participate. If, however, the corporation held the activity through a PTP or the activity is a significant participation activity, special rules apply. See **Publicly Traded Partnerships (PTPs)** on page 10. See Pub. 925 for how to report income or losses from significant participation passive activities.

In general, if the corporation has credits from passive activities, use Worksheet 5 on page 11 to figure the amount to enter in Part II of Form 8810. However, if the corporation held the activity through a PTP, special rules apply. See **Credits From PTPs** on page 12 for how to report credits from these activities.

### Material or Significant Participation

**In general.**—Personal service corporations and closely held corporations materially or significantly participate in an activity if one or more individuals, each of whom would materially or significantly participate in the activity if the corporation's activity were the individual's activity, directly or indirectly own more than 50% (by value) of the corporation's outstanding stock.

For this purpose, an individual's participation in all activities other than activities of the corporation is disregarded.

A closely held corporation also materially participates in an activity if the corporation satisfies the requirements of section 465(c)(7)(C) (without regard to (iv) for the "qualifying business" exception from the at-risk limitations).

These requirements are met if:

1. During the entire 12-month period ending on the last day of the tax year, substantially all the services of at least one full-time employee of the corporation were in the active management of the activity;
2. During the same period, substantially all the services of at least

three full-time nonowner employees were directly related to the activity; and

3. The deductions attributable to the activity and allowed solely under sections 162 and 404 exceed 15% of the gross income from the activity for the tax year.

Participation, for purposes of the material participation tests listed below, generally includes any work the individual did (without regard to the capacity in which the individual did it) in connection with an activity in which the corporation owned an interest at the time the individual did the work. Work is not treated as participation, however, if the work is not work that an owner of that type of activity would customarily do, and if one of the individual's main reasons for doing the work is to avoid the disallowance of losses or credits from the activity under the passive loss and credit rules.

Work the individual did as an investor in an activity is not treated as participation unless the individual was directly involved in the day-to-day management or operations of the activity. Work done as an investor includes:

1. Studying and reviewing financial statements or reports on operations of the activity.
2. Preparing or compiling summaries or analyses of the finances or operations of the activity for the individual's own use.
3. Monitoring the finances or operations of the activity in a nonmanagerial capacity.

If the individual is married for the tax year, the individual's participation in an activity includes any participation in the activity during the tax year by that individual's spouse, whether or not the spouse owned any interest in the activity and whether or not the individual and spouse file a joint return for the tax year.

An individual would materially participate in an activity of the corporation if one or more of the following tests are satisfied:

1. The individual participated in the activity for more than 500 hours.
2. The individual's participation in the activity for the tax year was substantially all of the participation in the activity of all individuals (including individuals who did not own any interest in the corporation or the activity) for the year.
3. The individual participated in the activity for more than 100 hours during the tax year, and that individual participated at least as much as any other individual (including individuals who did not own any interest in the corporation or the activity) for the year.
4. The activity is a significant participation activity for the individual for the tax year, and the individual's total

participation in all significant participation activities during the year exceeded 500 hours. A **significant participation activity** is any trade or business activity in which the individual participated for more than 100 hours during the year and in which the individual did not materially participate under any of the material participation tests (other than this test 4).

For this purpose, an individual's participation in all activities other than activities of the corporation is disregarded.

5. The individual materially participated in the activity for any 5 (whether or not consecutive) of the 10 preceding tax years. When determining whether the individual materially participated in tax years beginning before 1987, the individual materially participated only if the individual participated for more than 500 hours during the tax year.

6. The activity is a personal service activity in which the individual materially participated for any 3 (whether or not consecutive) preceding tax years. When determining whether the individual materially participated for tax years beginning before 1987, the individual materially participated only if the individual participated for more than 500 hours during the tax year.

An activity is a personal service activity if it involves the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor.

7. Based on all the facts and circumstances, the individual participated in the activity on a regular, continuous, and substantial basis during the tax year.

The individual did not materially participate in the activity under this seventh test, however, if the individual participated in the activity for 100 hours or less during the year. Participation in managing the activity does not count in determining whether the individual materially participated under the test if:

a. Any person (except that individual) received compensation for performing services in the management of the activity; or

b. Any person in the activity spent more hours during the tax year than that individual spent performing services in the management of the activity (regardless of whether the individual was compensated for the management services).

**Proof of participation.**—Participation in an activity can be proved by any reasonable means. Contemporaneous daily time reports, logs, or similar documents are not required if

participation can be established by other reasonable means. Reasonable means for this purpose may include, but are not limited to, the identification of services performed over a period of time and the approximate number of hours spent performing the services during that period, based on appointment books, calendars, or narrative summaries.

**Special rules for limited partners.**—Generally, a limited partner **cannot** materially participate in an activity. However, the corporation is considered to materially participate in an activity in which it holds a limited partner interest if one or more individuals, each of whom would materially participate in the activity under test 1, 5, or 6 for the tax year if the corporation's activity were the individual's activity, directly or indirectly own more than 50% (by value) of the corporation's outstanding stock.

The corporation is not treated as a limited partner, however, if the corporation was a general partner in the partnership at all times during the partnership's tax year ending with or within the corporation's tax year (or, if shorter, during the portion of the partnership's tax year in which the corporation directly or indirectly owned a limited partner interest).

**Participation of consolidated group.**—See Regulations section 1.469-1(h)(4) for rules for determining whether a consolidated group materially or significantly participates.

## Grouping the Corporation's Activities

**Note:** *These rules are based on final Regulations section 1.469-4 and generally are effective for tax years ending after May 10, 1992. However, if the corporation's tax year began before October 4, 1994, the corporation may choose to apply the rules in Proposed Regulations section 1.469-4 (and explained in the 1993 Instructions for Form 8810), rather than these rules.*

Generally, one or more trade or business activities or rental activities may be treated as a single activity if the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules. Whether activities make up an appropriate economic unit depends on all the relevant facts and circumstances. The factors given the greatest weight in determining whether activities make up an appropriate economic unit are:

1. Similarities and differences in types of trades or businesses,
2. The extent of common control,
3. The extent of common ownership,
4. Geographical location, and
5. Interdependencies between the activities.

**Example.** The corporation has a significant ownership interest in a bakery and a movie theater in Baltimore and in a bakery and a movie theater in Philadelphia. Depending on all the relevant facts and circumstances, there may be more than one reasonable method for grouping the corporation's activities. For instance, the following groupings may or may not be permissible: a single activity, a movie theater activity and a bakery activity, a Baltimore activity and a Philadelphia activity, or four separate activities.

Once the corporation chooses a grouping under these rules, it must continue using that grouping in later tax years unless a material change in the facts and circumstances makes it clearly inappropriate.

The IRS may regroup the corporation's activities if the grouping fails to reflect one or more appropriate economic units and one of the primary purposes of the grouping is to circumvent the passive activity limitations.

**Limitation on grouping certain activities.**—The following activities may **not** be grouped together:

1. A rental activity with a trade or business activity unless the activities being grouped together make up an appropriate economic unit, and

a. The rental activity is insubstantial relative to the trade or business activity or vice versa, or

b. Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity. If so, the portion of the rental activity involving the rental of property to be used in the trade or business activity may be grouped with the trade or business activity.

2. An activity involving the rental of real property with an activity involving the rental of personal property (except for personal property provided in connection with the real property or vice versa).

3. Any activity with another activity in a different type of business and in which the corporation holds an interest as a limited partner or as a limited entrepreneur (as defined in section 464(e)(2)) if that other activity engages in holding, producing, or distributing motion picture films or videotapes; farming; leasing section 1245 property; or exploring for (or exploiting) oil and gas resources or geothermal deposits.

**Activities conducted through partnerships and other C corporations subject to section 469.**—Once a partnership or corporation determines its activities under these rules, a partner or shareholder may use these rules to group those activities with each other, with activities conducted directly by the partner or shareholder, and with activities conducted through other

partnership and corporations. A partner or shareholder may not treat as separate activities those activities grouped together by the partnership or corporation.

**Partial disposition of an activity.**—The corporation may treat the disposition of substantially all of an activity as a separate activity if it can prove with reasonable certainty:

1. The prior year unallowed losses, if any, allocable to the part of the activity disposed of, and
2. The net income or loss for the year of disposition allocable to the part of the activity disposed of.

## Passive Activity Income and Deductions

Take into account only passive activity income and passive activity deductions in determining the corporation's overall gain or overall loss from all passive activities or any passive activity. To figure its passive activity loss, a closely held corporation subtracts both passive activity income and net active income from its passive activity deductions. See the instructions for line 2 on page 8 for the definition of net active income.

### Passive Activity Income

Passive activity income includes all income from passive activities, including (with certain exceptions described in Temporary Regulations section 1.469-2T(c)(2) and Regulations section 1.469-2(c)(2)) gain from the disposition of an interest in a passive activity or property used in a passive activity at the time of the disposition.

Passive activity income **does not** include the following:

- Income from an activity that is not a passive activity.
- Portfolio income, including interest, dividends, annuities, and royalties not derived in the ordinary course of a trade or business, and gain or loss from the disposition of property that produces those types of income or is held for investment. See Temporary Regulations section 1.469-2T(c)(3).
- Personal service income, including commissions and income from trade or business activities in which the corporation materially participated for the tax year. See Temporary Regulations section 1.469-2T(c)(4).
- Income from positive section 481 adjustments allocated to activities other than passive activities. See Temporary Regulations section 1.469-2T(c)(5).
- Income or gain from investments of working capital in an activity.
- Income from an oil or gas property if the corporation treated any loss from a working interest in the property for any tax year beginning after 1986 as a nonpassive loss under the rule excluding

working interests in oil and gas wells from passive activities. See Regulations section 1.469-2(c)(6).

- Income treated as income that is not passive activity income under Temporary Regulations section 1.469-2T(f) and Regulations section 1.469-2(f). See **Recharacterization of Passive Income** below.

- Overall gain from any interest in a publicly traded partnership.
- State, local, and foreign income tax refunds.
- Any reimbursement of a casualty or theft loss included in income to recover all or part of a prior year loss deduction, if the deduction for the loss was not treated as a passive activity deduction.
- Cancellation of debt income to the extent that, at the time the debt is discharged, the debt is not properly allocable under Temporary Regulations section 1.163-8T to passive activities.

### Passive Activity Deductions

Passive activity deductions include all deductions from activities that are passive activities for the tax year and all deductions from passive activities that were disallowed under the passive loss rules in prior tax years and carried forward to the tax year under section 469(b). See Regulations section 1.469-1(f)(4).

Passive activity deductions include losses from dispositions of property used in a passive activity at the time of the disposition and losses from a disposition of less than an entire interest in a passive activity. See **Dispositions** on page 6 for the treatment of losses on certain dispositions of an entire interest in an activity.

Passive activity deductions **do not** include the following:

- Deductions for expenses (other than interest expense) that are clearly and directly allocable to portfolio income.
- Dividends-received deductions for dividends not included in passive activity gross income.
- Interest expense, other than interest expense properly allocable under Temporary Regulations section 1.163-8T to passive activities. For example, capitalized interest expense is not a passive activity deduction.
- Losses from dispositions of property that produces portfolio income or property held for investment.
- State, local, and foreign income taxes.
- Charitable contribution deductions.
- Net operating loss deductions, percentage depletion carryovers under section 613A(d), and capital loss carrybacks and carryovers.
- Deductions and losses that would have been allowed for tax years

beginning before 1987, but for basis or at-risk limitations.

- Net negative section 481 adjustments allocated to activities other than passive activities. See Temporary Regulations section 1.469-2T(d)(7).
- Deductions for losses from fire, storm, shipwreck or other casualty, or from theft, if losses similar in cause and severity do not recur regularly in the activity.

### Recharacterization of Passive Income

Certain income from passive activities may be recharacterized and excluded from passive activity income. The amount of income recharacterized equals the net income from the sources described below. If during the tax year the corporation received net income from any sources described below (either directly or through a partnership), see Pub. 925 for details on reporting net income or loss from these sources. Also see Temporary Regulations section 1.469-2T(f) and Regulations section 1.469-2(f) for more information.

Income from the following sources may be subject to the net income recharacterization rules.

- Significant participation passive activities. A significant participation passive activity is any trade or business activity (as defined on page 3) in which the corporation is treated as having participated for more than 100 hours during the tax year but did not materially participate.
- Rental of property when less than 30% of the unadjusted basis of the property is subject to depreciation.
- Passive equity-financed lending activities.
- Rental of property incidental to a development activity.
- Rental of property to an activity in which the corporation materially participates.
- Acquisition of an interest in a pass-through entity that licenses intangible property.

### Former Passive Activities

A former passive activity is any activity that was a passive activity in a prior tax year, but is not a passive activity in the current tax year. A prior year unallowed loss from a former passive activity is allowed to the extent of the current year income from the activity.

If the current year net income from the activity is less than the prior year unallowed loss, enter the prior year unallowed loss and any current year net income from the activity on Form 8810 and the applicable worksheets.

If the current year net income from the activity is equal to or greater than the prior year unallowed loss from the

activity, report the income and loss on the forms and schedules normally used; do not enter the amounts on Form 8810.

If the activity has a net loss for the current year, enter the prior year unallowed loss (but not the current year loss) on Form 8810 and the applicable worksheets.

To report a disposition of a former passive activity, follow the rules under **Dispositions** below.

## Dispositions

### Disposition of Less Than an Entire Interest

Gains and losses from the disposition of less than an entire interest in an activity are treated as part of the overall gain or loss from the activity for the current year. A disposition of less than an entire interest does not trigger the allowance of prior year unallowed losses.

### Disposition of an Entire Interest

If the corporation disposed of its entire interest in a passive activity or a former passive activity to an unrelated party in a fully taxable transaction during the tax year, the losses allocable to the activity for the year are not limited by the passive activity loss rules. A fully taxable transaction is a transaction in which all of the realized gain or loss is recognized.

If the corporation is using the installment method to report this kind of

disposition, figure the allowed loss for the current year by multiplying the overall loss (which **does not** include losses allowed in prior years) by the following fraction:

$$\frac{\text{Gain recognized in the current year}}{\text{Unrecognized gain as of the beginning of the current year}}$$

Unallowed passive activity credits, unlike unallowed passive activity losses, are not allowable when the corporation disposes of its interest in an activity. However, the corporation may elect to increase the basis of the credit property by the amount of the original basis reduction of the property to the extent that the credit has not been allowed by reason of the passive activity rules. To make the election, complete Part III of Form 8810. No basis adjustment may be elected on a partial disposition of the corporation's interest in a passive activity.

A partner in a publicly traded partnership (PTP) is not treated as having disposed of an entire interest in an activity of a PTP until there is an entire disposition of the partner's interest in the PTP.

### Reporting an Entire Disposition on Schedule D or Form 4797

When the corporation completely disposes of an entire interest in a passive activity, there may be net

income or loss and prior year unallowed losses from the activity. All of the income, gains, deductions, and losses are reported on the forms and schedules normally used.

The income, gains, deductions, and losses from these activities are only entered on Form 8810 if there is an overall gain when combining all income, gains, deductions, and losses, including prior year unallowed losses, from the activity, and the corporation has other passive activities to report on Form 8810. Report the income, gains, deductions, and losses on the forms or schedules normally used and also enter the income, gains, deductions, and losses on Worksheet 1 on page 7 if there are other passive activities to report on Form 8810.

If there is an overall loss after combining the income, gains, deductions, and losses (including prior year unallowed losses) from the activity, report all of the income, gains, deductions, and losses on the proper forms and schedules, but do not enter them on the worksheets or on Form 8810.

**Note:** *Members of a consolidated group, see Temporary Regulations section 1.469-1T(h)(6), (7), and (8) for rules on applying the passive loss rules to dispositions of property and other intercompany transactions.*

# Specific Instructions

**Note:** Complete Worksheets 1 and 2 before completing Part I of Form 8810.

## Worksheet 1

Worksheet 1 is used to figure the total current year income, gains, deductions, and losses for each passive activity.

Gross receipts and other income from passive activities and passive activity gains reported on Form 4797 and Schedule D are entered on lines 1 through 4 of Worksheet 1. Passive activity deductions are entered on lines 6a through 6l, and passive activity losses reported on Schedule D and Form 4797 are entered on lines 8 and 9. The total income from line 5 is entered in column (a) of Worksheet 2 and the total deductions and losses from line 10 are entered in column (b) of Worksheet 2.

Gross receipts, gains from the sale of business assets, capital gains, and other passive income should also be entered on the forms and schedules normally used. Allowable passive activity deductions and losses are entered on the forms and schedules after Form 8810 is completed and the deductions and losses are allocated to the activities.

## Worksheet 1—Computation of Income, Gains, Deductions, and Losses for Worksheet 2

	Name of activity:	Name of activity:
1. Gross receipts . . . . .		
2. Schedule D gains . . . . .		
3. Form 4797 gains . . . . .		
4. Other passive income . . . . .		
5. <b>Total income.</b> Add lines 1 through 4 and enter the result in column (a) of Worksheet 2 . . . . . ▶		
<b>6. Deductions:</b>		
a. Cost of goods sold . . . . .		
b. Compensation of officers . . . . .		
c. Salaries and wages . . . . .		
d. Repairs and maintenance . . . . .		
e. Bad debts . . . . .		
f. Rents . . . . .		
g. Taxes and licenses . . . . .		
h. Interest . . . . .		
i. Depreciation . . . . .		
j. Depletion . . . . .		
k. Advertising . . . . .		
l. Other deductions . . . . .		
7. <b>Total deductions.</b> Add lines 6a through 6l . . . . .		
8. Schedule D losses . . . . .		
9. Form 4797 losses . . . . .		
10. <b>Total deductions and losses.</b> Add lines 7 through 9 and enter the result here and in column (b) of Worksheet 2 . . . . . ▶		

## Worksheet 2

Total income for the current year is shown on line 5 in Worksheet 1 and total deductions and losses for the current year are shown on line 10 in Worksheet 1. The prior year unallowed losses can be found in the corporation's Worksheet 4, column (c) of the 1993 Form 8810 instructions. The totals from columns (a), (b), and (c) of Worksheet 2 are entered on lines 1a, 1b, and 1c of Form 8810.

Combine income, deductions, and losses in columns (a) through (c) for each activity. Enter any overall gain in column (d) or any overall loss in column (e). Columns (d) and (e) are not entered on Form 8810. These amounts will be used when Form 8810 is completed to figure the loss allowed for the current year.

### Worksheet 2 for Form 8810, Lines 1a, 1b, and 1c

Name of activity	Current year		Prior year	Overall gain or loss	
	(a) Income (line 1a)	(b) Deductions and losses (line 1b)	(c) Unallowed losses (line 1c)	(d) Gain	(e) Loss
<b>Totals. Enter on lines 1a,1b, and 1c of Form 8810 . . . . . ▶</b>					

## Part I—1994 Passive Activity Loss

**Lines 1d and 3.**—If line 1d or 3 shows net income or zero, all the deductions and losses are allowed including any prior year unallowed losses entered on line 1c. Enter the deductions on the appropriate lines of Form 1120 and any losses from Form 4797 or Schedule D (Form 1120) on that form or schedule, if applicable, including any prior year unallowed losses that should go on those forms. If the prior year unallowed losses include deductions that would have been reported on page 1 of Form 1120 instead of on Form 4797 or Schedule D, include the prior year unallowed losses on the appropriate line along with any current year deduction or loss from that line. For example, the corporation had \$1,000 of deductions for current year repairs and maintenance and \$500 of deductions for prior year unallowed repairs and maintenance. Enter \$1,500 as the deduction for repairs and maintenance allowed from passive activities on the proper line.

**Line 2—Closely held corporations.**—Closely held corporations can offset the loss, if any, on line 1d with net active income. **Net active income** is the corporation's taxable income for the tax year, determined without regard to the following items:

- Net passive income or loss.
- Portfolio income. See **Passive Activity Income** on page 5.
- Deductions attributable to portfolio income described in Temporary Regulations section 1.469-2T(d)(2)(i), (ii), and (iv).
- Interest expense allocated under Temporary Regulations section 1.163-8T to a portfolio expenditure (within the meaning of Temporary Regulations section 1.163-8T(b)(6)).
- Gain on the disposition of substantially appreciated property formerly held for investment. See Regulations section 1.469-2(c)(2)(iii)(F).
- Gross income from certain oil or gas properties treated under Regulations section 1.469-2(c)(6) as not from a passive activity.
- Gross income and deductions from any trade or business activity of trading certain personal property described in Temporary Regulations section 1.469-1T(e)(6), but only if the corporation does not materially participate in the activity for the tax year.

If the corporation disposed of its entire interest in a passive activity to an unrelated party in a fully taxable

transaction, figure net active income by taking into account an overall loss from that activity only to the extent it exceeds overall gain from all other passive activities (the gain, if any, shown on line 1d of Form 8810). If there is an overall loss from all other passive activities (line 1d of Form 8810 is a loss), figure net active income by taking into account all of the overall loss from that activity.

**Line 4.**—Use Worksheet 3 below and Worksheet 4 on page 9 to figure the unallowed deductions and losses to be carried forward and the allowed deductions and losses to report on the forms and schedules for 1994. Worksheet 2, columns (d) and (e), will show whether an activity had an overall gain or loss. If an activity has an overall gain in column (d) of Worksheet 2, report all of the deductions and losses listed in Worksheet 1 and any prior year unallowed losses in Worksheet 2 for those activities on the appropriate lines of Form 1120 and on Schedule D or Form 4797, if applicable.

Use Worksheets 3 and 4 for activities in Worksheet 2 that show an overall loss in column (e).

### Worksheet 3

If the corporation has activities in Worksheet 2 with an overall loss in column (e), use Worksheet 3 to figure the unallowed deductions and losses for each activity.

If any of the activities in Worksheet 2 had an overall gain in column (d), all of the deductions and losses (including prior year unallowed losses) for that activity are allowed in full. Enter the deductions on the appropriate line of Form 1120 and enter any losses on Form 4797 or Schedule D, if applicable.

**Note:** *If there were prior year unallowed losses from 1993, include the prior year unallowed losses on the appropriate line along with any current year deduction or loss for that line. See the example in the instructions for lines 1d and 3 above. Prior year unallowed losses from Form 4797 and Schedule D (Form 1120) should have been kept separate last year and should be identified as "prior year unallowed passive activity losses" on Form 4797 and Schedule D (Form 1120).*

**Column (a).**—Enter the loss from column (e) of Worksheet 2.

**Column (b).**—Divide each of the individual losses in column (a) by the total of all the losses in column (a) and enter the ratio for each of the activities in column (b). The total of all the ratios should equal 1.00.

**Column (c).**—Multiply the unallowed loss from line 3 of Form 8810 by each of the ratios in column (b) and enter the results in column (c).

Use Worksheet 4 to figure the allowed deductions and losses.

### Worksheet 3—Allocation of Unallowed Deductions and Losses

Name of activity	(a) Loss from Worksheet 2 col. (e)	(b) Ratio (see instr.)	(c) Unallowed deductions and losses (see instr.)
<b>Totals</b> . . . . . ▶		<b>1.00</b>	

## Worksheet 4

Use Worksheet 4 to allocate the unallowed deductions and losses for each activity among Form 1120 deductions and any losses to be reported on Form 4797 and Schedule D.

If the unallowed loss is reported on one form or schedule, skip the following example and complete Worksheet 4.

If the unallowed loss is from losses reported on more than one form or schedule, allocate the unallowed loss from column (c) of Worksheet 3 among the net losses as follows:

**Example.** The corporation has one passive activity. The activity has an unallowed loss of \$18,000 in column (c) of Worksheet 3 and the following net losses and net gain:

Form 1120		Form 4797	
Gross receipts	\$100,000	Gain	\$5,000
Deductions	<u>120,000</u>	Loss	<u>(2,000)</u>
Net loss	(\$20,000)	Net gain	\$3,000

  

Schedule D	Form 4797
Gain	\$1,000
Loss	<u>(2,000)</u>
Net loss	(\$1,000)

Add the net losses of \$20,000 and \$1,000, for a total of \$21,000. Divide the net loss reported on each form by the total of the net losses, and multiply the result by the unallowed loss of \$18,000, as shown below:

$$\text{Form 1120: } \frac{\$20,000}{\$21,000} \times \$18,000 = \$17,143$$

$$\text{Schedule D: } \frac{\$1,000}{\$21,000} \times \$18,000 = \$857$$

On Form 4797, report the full \$2,000 loss and the \$5,000 gain. On Worksheet 4, enter the \$17,143 of unallowed deductions allocated to Form 1120 in column (c) on the line for total Form 1120 deductions. Enter the \$857 of unallowed Schedule D losses in column (c) of line 2. Worksheet 4 is used to allocate the \$17,143 to the Form 1120 deductions and show the allowed and unallowed Schedule D loss.

**Line 1, column (a).**—Enter the current year deductions for each Form 1120 expense (lines 6a through 6l of Worksheet 1) plus any prior year unallowed Form 1120 deduction for that activity. For example, if line 6i of Worksheet 1 shows current year depreciation for the activity of \$2,200, and the activity had prior year unallowed depreciation of \$1,200, enter \$3,400 on line 1i, column (a), of Worksheet 4.

**Line 2, column (a).**—Enter any Schedule D losses from line 8 of Worksheet 1 plus any prior year unallowed Schedule D losses for that activity.

**Line 3, column (a).**—Enter any Form 4797 losses from line 9 of Worksheet 1 plus any prior year unallowed Form 4797 losses for that activity.

**Line 1, column (b).**—Divide each of the individual Form 1120 deductions shown in column (a) by the total of all of the Form 1120 deductions in column (a) and enter the ratio for each of the deductions in column (b). The total of the ratios must equal 1.00.

**Column (c).**—Allocate the portion of the loss in Worksheet 3, column (c), among

the Form 1120 deductions by multiplying the unallowed loss attributable to the total Form 1120 deductions by each of the ratios in column (b). Enter the portion of the unallowed loss in Worksheet 3, column (c) that is attributable to a Schedule D or Form 4797 loss in column (c) of this worksheet.

**Column (d).**—Subtract column (c) from column (a) and enter the results in this column. Enter the deductions allowed for Form 1120 on the proper lines of Form 1120 and enter the allowed Schedule D and Form 4797 losses on that form or schedule.

### Worksheet 4—Allowed Deductions and Losses

Name of activity:	(a) Deductions and losses	(b) Ratio	(c) Unallowed deductions and losses	(d) Allowed deductions and losses
1. Form 1120 deductions:				
a. Cost of goods sold . . . . .				
b. Compensation of officers . . . . .				
c. Salaries and wages . . . . .				
d. Repairs and maintenance . . . . .				
e. Bad debts . . . . .				
f. Rents . . . . .				
g. Taxes and licenses . . . . .				
h. Interest . . . . .				
i. Depreciation . . . . .				
j. Depletion . . . . .				
k. Advertising . . . . .				
l. Other deductions . . . . .				
<b>Total Form 1120 deductions ►</b>		<b>1.00</b>		
2. Schedule D losses . . . . .				
3. Form 4797 losses . . . . .				
Name of activity:	(a) Deductions and losses	(b) Ratio	(c) Unallowed deductions and losses	(d) Allowed deductions and losses
1. Form 1120 deductions:				
a. Cost of goods sold . . . . .				
b. Compensation of officers . . . . .				
c. Salaries and wages . . . . .				
d. Repairs and maintenance . . . . .				
e. Bad debts . . . . .				
f. Rents . . . . .				
g. Taxes and licenses . . . . .				
h. Interest . . . . .				
i. Depreciation . . . . .				
j. Depletion . . . . .				
k. Advertising . . . . .				
l. Other deductions . . . . .				
<b>Total Form 1120 deductions ►</b>		<b>1.00</b>		
2. Schedule D losses . . . . .				
3. Form 4797 losses . . . . .				

## Publicly Traded Partnerships (PTPs)

A publicly traded partnership (PTP) is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market (or its substantial equivalent).

An established securities market includes any national securities exchange and any local exchange registered under the Securities Exchange Act of 1934 or exempted from registration because of the limited volume of transactions. It also includes any over-the-counter market.

A secondary market generally exists where a person stands ready to make a market in the interest. An interest is treated as readily tradable if the interest is regularly quoted by persons, such as brokers or dealers, who are making a market in the interest.

The substantial equivalent of a secondary market exists where there is no identifiable market maker, but the holder of an interest has a readily available, regular, and ongoing opportunity to sell or exchange an interest through a public means of obtaining or providing information of offers to buy, sell, or exchange interests. Similarly, the substantial equivalent of a secondary market exists where the prospective buyers and sellers have the opportunity to buy, sell, or exchange interests in a time frame and with the regularity and continuity that the existence of a market maker would provide.

**Special instructions for PTPs.**—Losses from passive activities the corporation holds through a PTP generally can be used only to offset income or gain from passive activities of the same PTP. Any unallowed loss from a PTP passive activity is carried forward and allowed in a tax year when the corporation has passive income from the same PTP or when the corporation disposes of its entire interest in that PTP.

Income from passive activities the corporation holds through a PTP cannot be used to offset losses from passive activities the corporation holds through another PTP or losses from any other passive activities.

**Passive activity loss rules for partners in PTPs.**—Do not include any income, gains, deductions, or losses from PTP passive activities on Form 8810. Instead, use the following rules to figure and report income, gains, deductions, and losses from the PTP passive activity or activities held through each PTP that the corporation owned an interest in during the tax year:

1. Combine any current year income, gains, deductions, and losses, and prior year unallowed losses to see if there is an overall gain or loss. Include only the

same types of income and losses that would be included in figuring net income or loss from a non-PTP passive activity (see **Passive Activity Income and Deductions** on page 5).

2. If there is an overall gain, the net gain portion (total income in excess of total deductions and losses) is nonpassive income. Report the income, deductions, and losses on the forms and schedules normally used.

3. If there is an overall loss (other than in a year in which the corporation disposed of its entire interest in the PTP), the deductions and losses are allowed to the extent of the income, and the excess deductions and losses are carried forward for use in a future year when there is income to offset them. Report the income and the loss allowed to the extent of income on the form or schedule normally used.

## Part II—1994 Passive Activity Credits

Use Part II of Form 8810 to figure the amount of credits allowed from passive activities for the current year and the amount that is unallowed and carried forward.

The following credits from passive activities are included on Form 8810:

- Investment credit (including the rehabilitation credit, energy credit, and reforestation credit);
- Jobs credit;
- Credit for alcohol used as fuel;
- Credit for increasing research activities;
- Low-income housing credit;
- Enhanced oil recovery credit;
- Disabled access credit;
- Renewable electricity production credit;
- Empowerment zone employment credit;
- Indian employment credit;
- Credit for employer social security and Medicare taxes paid on certain employee tips;
- Credit for contributions to selected community development corporations;
- Possessions corporation tax credit;
- Orphan drug credit;
- Qualified electric vehicle credit; and
- Nonconventional source fuel credit.

Credits from passive activities are any of the credits listed above from:

- A trade or business activity in which the corporation did not materially participate. See **Trade or Business Activities** on page 3.
- A rental activity (other than a rental real estate activity in which the corporation materially participated, if the corporation was a closely held corporation that derived more than 50%

of its gross receipts from real property trades or businesses in which it materially participated). See **Rental Activities** on page 2.

## Worksheet 5

Use Worksheet 5 on page 11 to figure the amounts to enter on line 5a and 5b of Form 8810.

**Column (a).**—Convert any current year qualified expenditures into credits before beginning Worksheet 5. Use the following forms:

**Form 3800, General Business Credit.**—Enter the credits from line 2 of Form 3800 in column (a) of Worksheet 5. If the credits are from more than one activity or more than one type of credit, separate the credits by activity or type before making entries in the worksheet. For example, the corporation has a jobs credit from one passive activity and a research credit from a different passive activity. Enter the jobs credit and the research credit on separate lines in column (a) of Worksheet 5.

**Form 5735, Possessions Corporation Tax Credit Allowed Under Section 936.**—Enter the portion of the section 936 credit attributable to passive activities from Form 5735 in column (a) of Worksheet 5.

**Form 6765, Credit for Increasing Research Activities (or for claiming the orphan drug credit).**—Complete Part I if you have an orphan drug credit. Enter the portion of the credit attributable to passive activities from line 4 of Form 6765 in column (a) of Worksheet 5.

**Form 8586, Low-Income Housing Credit.**—If the corporation is not required to file Form 3800, enter the portion of the credit attributable to passive activities from line 6 of Form 8586 in column (a) of Worksheet 5.

**Form 8834, Qualified Electric Vehicle Credit.**—Enter the credits from line 10 of Form 8834 in column (a) of Worksheet 5. If the credits are from more than one activity, separate the credits by activity before making entries in the worksheet.

**Form 8844, Empowerment Zone Employment Credit.**—Enter the credits from line 5 in column (a) of Worksheet 5. If the credits are from more than one activity, separate the credits by activity before making entries in the worksheet.

**Nonconventional source fuel credit.**—Figure the credit from passive activities for fuel produced from a nonconventional source and enter the credit in column (a) of Worksheet 5. See section 29 for more information on the credit for fuel produced from a nonconventional source.

**Column (b).**—In figuring this year's passive activity credit, the corporation must take into account any credits from passive activities disallowed for prior



## Worksheet 6

Use Worksheet 6 to allocate the allowed and unallowed credits for each activity.

**Column (a).**—Enter the total credits from column (c) of Worksheet 5.

**Column (b).**—Divide each of the credits in column (a) by the total of all credits in

column (a). The total of the ratios should equal 1.00.

**Column (c).**—Multiply line 8 of Form 8810 by the ratios in column (b) and enter the results in column (c). These are the **unallowed credits** for 1994. Keep a

record of these amounts so the credits can be carried to the next year.

**Column (d).**—Subtract column (c) from column (a). These are the **allowed credits** for 1994. The amounts in this column should be reported on the forms normally used. See **Reporting Allowed Credits on Tax Return** below.

### Worksheet 6—Allowed and Unallowed Credits

Name of activity	Form To Be Reported on	(a) Credits (see instructions)	(b) Ratio (see instructions)	(c) Unallowed Credits (see instructions)	(d) Allowed Credits (see instructions)
<b>Totals</b>	▶		<b>1.00</b>		

### Reporting Allowed Credits on Tax Return

**Form 3800.**—Enter on line 4 of Form 3800 the total passive activity general business credit allowed from column (d) of Worksheet 6.

**Form 5735.**—Enter on Form 5735 any allowed possessions corporation tax credit. To the left of the entry write, "PAC."

**Form 6765.**—Enter on line 4 of Form 6765 any allowed orphan drug credit. To the left of the entry write, "PAC." Also complete Part II of that form.

**Form 8586.**—If the corporation is not required to file Form 3800, enter on line 7 of Form 8586 any allowed low-income housing credit.

**Form 8834.**—Enter on line 12 of Form 8834 the passive activity qualified electric vehicle credit allowed from column (d) of Worksheet 6.

**Form 8844.**—Enter on line 7 of Form 8844 the passive activity empowerment zone employment credit allowed from column (d) of Worksheet 6.

**Nonconventional source fuel credit.**—If the corporation has an allowed passive activity credit for fuel produced from a nonconventional source, see section 29 for limitations and adjustments to the credit. Attach a separate schedule to the

tax return showing how the credit was figured. Combine any nonpassive credits for fuel from a nonconventional source with the passive activity credit before applying the limitations and adjustments. Report the credit on the line specified by the instructions for the tax return being filed.

### Credits From PTPs

A credit from a passive activity held through a PTP is allowed to the extent of the tax attributable to net passive income from that PTP. See page 10 for the definition of a PTP.

Do not enter credits from PTPs on Form 8810 or the worksheets. Instead, use the following steps to figure the allowed and unallowed credits from passive activities held through PTPs:

1. Figure the tax attributable to net passive income for each PTP with current year passive activity credits or prior year unallowed credits.
2. Use the smaller of the tax attributable to net income from passive activities of the PTP or the credit (including prior year unallowed credits) from passive activities of the PTP as the amount allowed. Report the allowed credits on the form normally used and keep a record of the unallowed credits to be carried to the next year.

### Part III—Election To Increase Basis of Credit Property

**Line 10.**—Check the box if the corporation elects to increase the basis of credit property it used in a passive activity or former passive activity by the unallowed credit that reduced the property's basis. The election is available for a fully taxable disposition of an entire interest in an activity for which a basis adjustment was made as a result of placing in service property for which a credit was taken. On such a disposition, the corporation may elect to increase the basis of the credit property immediately before the disposition (by an amount no greater than the amount of the original basis reduction) to the extent that the credit has not previously been allowed because of the passive credit limitations. The amount of the unallowed credit that may then be applied against tax is reduced by the amount of the basis adjustment.

No basis adjustment may be elected on a partial disposition of the corporation's interest in a passive activity or if the disposition is not fully taxable. The amount of any unallowed credit, however, remains available to offset the tax attributable to net passive and net active income.

