



Instructions for Form 8582

Passive Activity Loss 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 . . . 1 hr., 5 min.

Learning about the law or the form . . . 1 hr., 43 min.

Preparing the form . . . 1 hr., 34 min.

Copying, assembling, and sending the form to the IRS 20 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. See the instructions for the tax return with which this form is filed.

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General Instructions

Purpose of Form

Form 8582 is used by noncorporate taxpayers to figure the amount of any passive activity loss for the current tax year and the total losses allowed from passive activities. You have a passive activity loss for the year if the total losses (including prior year unallowed losses) from all your passive activities exceed the total income from all your passive activities.

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

Passive activity losses cannot be used to offset income from nonpassive activities. However, a special allowance for rental real estate activities with active participation may allow some losses even if the losses exceed passive income.

Passive activity losses that are not allowed in the current year are carried forward until they are allowed either against passive activity income, against the special allowance, if applicable, or when you sell or exchange your entire interest in the activity in a fully taxable transaction to an unrelated party.

For more information, see **Pub. 925, Passive Activity and At-Risk Rules**. This publication contains a filled-in example of Form 8582 with step-by-step instructions on how to report losses from passive activities.

Note: *Corporations subject to the passive activity rules must use Form 8810, Corporate Passive Activity Loss and Credit Limitations.*

Who Must File

Form 8582 is filed by individuals, estates, and trusts who have losses (including prior year unallowed losses) from passive activities. You do not

have to file Form 8582 if you meet **Exception 1** or **2** below.

Exception 1

You **do not** have an overall loss when you combine all your net income and net losses (including any prior year unallowed losses) from business or rental passive activities. Overall loss is defined under **Definitions** on page 2.

In figuring your overall gain or loss from all passive activities for the year, **do not** include the following:

1. Net income that is not passive activity income. See **Passive Activity Income** on page 6.
2. Net losses that are not passive activity net losses. See **Activities That Are Not Passive Activities** on page 2.
3. Net income or net loss from your interest in any publicly traded partnership. See **Publicly Traded Partnerships (PTPs)** on page 11.
4. Any overall loss from an entire disposition of a passive activity. See **Dispositions** on page 7 for more information.

Exception 2

You **actively participated** in rental real estate activities (see **Active Participation in a Rental Real Estate Activity** on page 4) and you meet **ALL** of the following conditions:

- Rental real estate activities with active participation were your only passive activities.
- You have no prior year unallowed losses from these activities.
- Your total loss from the rental real estate activities was not more than \$25,000 (\$12,500 if married filing separately and you lived apart from your spouse all year).
- If you are married filing separately, you lived apart from your spouse all year.
- You have no current or prior year unallowed credits from a passive activity.
- Your modified adjusted gross income was not more than \$100,000 (not more than \$50,000 if married filing separately and you lived apart from your spouse all year).

• You do not hold any interest in a rental real estate activity as a limited partner or as a beneficiary of an estate or a trust.

For the definition of modified adjusted gross income, see the instructions for line 6 on page 8.

If you meet all the conditions listed above, your rental real estate losses are not limited and you do not need to complete Form 8582. For losses reported on line 22, Part I of Schedule E, enter the amount of the loss from line 22 on line 23 of Schedule E. For losses from a partnership or an S corporation, enter the amount of the allowable loss from Schedule K-1 in Part II, column (g), of Schedule E. For losses reported on line 32 of **Form 4835**, Farm Rental Income and Expenses, enter the amount of the allowable loss from line 32 on line 33c of Form 4835.

If you do not qualify for Exception 1 or 2, you must complete Form 8582.

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, you must determine whether the loss is limited under the passive loss rules. Get **Form 6198**, At-Risk Limitations, for details on the at-risk rules. However, capital losses that are allowable under the passive loss rules may be limited under section 1211. Similarly, percentage depletion deductions that are allowable under the passive loss rules may be limited under section 613A(d).

Before Completing Form 8582

To see if your activity is treated as a passive activity, read:

- **Trade or Business Activities** if your activity is a trade or business activity (page 4).
- **Rental Activities** if your activity is the renting of tangible property (page 3).
- **Material Participation** (page 4).
- **Grouping Your Activities** (page 5).

To see how to treat income and deductions from your activity, read:

- **Passive Activity Income and Deductions, Former Passive Activities, and Dispositions** (pages 6 and 7).

To see how to enter income and losses on Form 8582, read the instructions for Worksheets 1 and 2 (page 8).

Overview of Form

The form consists of three parts.

Part I—1995 Passive Activity Loss.—Use Part I to combine the net income and net loss from all passive activities to determine if you have a passive activity loss for 1995.

If the net losses from all passive activities exceed the net income from all passive activities, you will have a passive activity loss for 1995.

Part II—Special Allowance for Rental Real Estate With Active Participation.—Use Part II to figure the maximum amount of rental loss allowed if you have a net loss from a rental real estate activity with active participation.

Part III—Total Losses Allowed.—Use Part III to figure the amount of the passive activity loss (as determined in Part I) that is allowed for 1995 from all passive activities.

Definitions

Except as otherwise indicated, the following terms in these instructions 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 losses from an activity that were disallowed under the passive activity loss limitations in a prior year and carried forward to the tax year under section 469(b). See Regulations section 1.469-1(f)(4) and Pub. 925.

Activities That Are Not Passive Activities

The following are not passive activities:

1. Trade or business activities in which you materially participated for the tax year.
2. Any rental real estate activity in which you materially participated, if you were a “real estate professional” for the tax year. You were a real estate professional only if you met both of the following conditions:
 - a. More than half of the personal services you performed in trades or businesses were performed in real property trades or businesses in which you materially participated, and
 - b. You performed more than 750 hours of services in real property trades or businesses in which you materially participated.

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

If you are married filing jointly, either you or your spouse must separately meet both of the above conditions, without taking into account services performed by the other spouse.

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. Services you performed as an employee are not treated as performed in a real property trade or business unless you owned more than 5% of the stock (or more than 5% of the capital or profits interest) in the employer.

Note: *If an activity qualifies for the exception described above in 1995, 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 7.*

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

If, however, your liability was not unlimited for the entire year (e.g., you converted your general partner interest to a limited partner interest during the

year), some of your 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. The rental of a dwelling unit you used as a residence if section 280A(c)(5) applies. This exception applies if you rented out a dwelling unit that you also used as a home during the year for a number of days that exceeds the greater of 14 days or 10% of the number of days during the year that the home was rented at a fair rental.

5. 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 and losses from these activities should not be entered on Form 8582. However, losses from these activities may be subject to limitations other than the passive loss rules.

Rental Activities

A rental activity is a passive activity even if you materially participated in the activity (other than a rental real estate activity in which you materially participated, if you were a real estate professional).

However, if you meet any one of the six exceptions listed below, the rental of the property is not treated as a rental activity. See **Reporting Income and Losses From the Activities** below if you meet any of the exceptions.

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. The activity is considered a rental activity even if the use is under a lease, a service contract, or some other arrangement that is not called a lease.

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 if 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 property's use.

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 of 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. You own 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. You customarily make the rental property available during defined business hours for nonexclusive use by various customers.

6. You provide property for use in a nonrental activity of a partnership, an S corporation, or a joint venture in your capacity as an owner of an interest in such partnership, S corporation, 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 and Losses From the Activities

If you meet any of the six exceptions listed above, your rental of the property is not a rental activity. You must then determine whether your rental of the property is a trade or business activity and, if so, whether you materially participated in the activity for the tax year (see **Trade or Business Activities** on page 4). If the activity is a trade or business activity in which you did not materially participate, enter the income and losses from the activity on Worksheet 2.

If you meet any of the six exceptions listed above and the activity is a trade or business activity in which you materially participated, report any income or loss from the activity on the forms or schedules you normally use.

If you **did not** meet any of the six exceptions, the rental activity is generally a passive activity. Special rules apply if you conduct the rental activity through a publicly traded partnership (PTP) or if any of the rules described under **Recharacterization of Passive Income** on page 7 apply. See the PTP rules on page 11.

If none of the special rules apply, a passive rental activity is entered on either Worksheet 1 or 2. Worksheet 1 is for passive rental real estate

activities in which you actively participated. See **Active Participation in a Rental Real Estate Activity** below. Worksheet 2 is for passive rental real estate activities in which you did not actively participate, activities of renting personal property, and other passive trade or business activities. See the instructions for Worksheets 1 and 2 on page 8.

Active Participation in a Rental Real Estate Activity

If you actively participated in a passive rental real estate activity, you may be able to deduct up to \$25,000 of the loss from the activity from nonpassive income. This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities. The special allowance is not available if you were married, file a separate return for the year, and did not live apart from your spouse at all times during the year.

Only individuals and qualifying estates can actively participate in a rental real estate activity. Estates (other than qualifying estates) and trusts cannot actively participate. Limited partners cannot actively participate unless future regulations provide an exception.

You are not considered to actively participate in a rental real estate activity if at any time during the tax year your interest (including your spouse's interest) in the activity was less than 10% (by value) of all interests in the activity.

Active participation is a less stringent requirement than material participation (see **Material Participation** below). You may be treated as actively participating if you participated, for example, in making management decisions or arranging for others to provide services (such as repairs) in a significant and bona fide sense. Management decisions that can count as active participation include approving new tenants, deciding on rental terms, approving capital or repair expenditures, and other similar decisions.

An estate is treated as actively participating for tax years ending less than 2 years after the date of the decedent's death if the decedent would have satisfied the active participation requirements for the activity for the tax year the decedent died. Such an estate is a qualifying estate.

The maximum special allowance that single individuals and married individuals filing a joint return for the tax year can qualify for is \$25,000. The maximum is \$12,500 for married

individuals who file separate returns for the tax year and who lived apart at all times during the tax year. The maximum special allowance for which an estate can qualify is \$25,000 reduced by the special allowance for which the surviving spouse qualified.

If your modified adjusted gross income (defined on page 8) is \$100,000 or less (\$50,000 or less if married filing separately), your loss is deductible up to the amount of the maximum special allowance referred to in the preceding paragraph. If your modified adjusted gross income is more than \$100,000 (\$50,000 if married filing separately), the special allowance is limited to 50% of the difference between \$150,000 (\$75,000 if married filing separately) and your modified adjusted gross income. When modified adjusted gross income is \$150,000 or more (\$75,000 or more if married filing separately), there is no special allowance.

If you qualify under the active participation rules, use Worksheet 1 and see page 8 of the instructions.

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 you chose to deduct rather than capitalize them).

Trade or business activities are generally reported on Schedule C, C-EZ, or F, or in Part II or III of Schedule E.

Reporting Income and Losses From the Activities

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

Trade or business activities without material participation.—If you did not materially participate in a trade or business activity, the activity is a passive activity. In general, you must use Worksheet 2 to determine the amount to enter on Form 8582. However, if you owned the activity through a publicly traded partnership or the activity is a significant

participation activity, special rules apply. See **Publicly Traded Partnerships (PTPs)** on page 11. See Pub. 925 for how to report income or losses from significant participation passive activities.

Material Participation

In general.—Participation, for purposes of the material participation tests listed below, generally includes any work you did in connection with an activity if you owned an interest in the activity at the time you did the work. The capacity in which you did the work does not matter. However, work is not treated as participation if it is not work that an owner would customarily do in the same type of activity, and one of your main reasons for doing the work was to avoid the disallowance of losses or credits from the activity under the passive activity rules.

Work you did as an investor in an activity is not treated as participation unless you were 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 your own use.
3. Monitoring the finances or operations of the activity in a nonmanagerial capacity.

You may prove your participation in an activity by any reasonable means. You do not have to maintain contemporaneous daily time reports, logs, or similar documents if you can establish your participation 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.

Participation by your spouse during the tax year in an activity you own may be counted as your participation in the activity. The participation by your spouse may be included as your participation even if your spouse did not own an interest in the activity and whether or not you and your spouse file a joint return for the tax year.

Tests for individuals.—You materially participated for the tax year in an activity if you satisfy one or more of the following tests:

1. You participated in the activity for more than 500 hours.

2. Your 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 activity) for the year.

3. You participated in the activity for more than 100 hours during the tax year, and you participated at least as much as any other individual (including individuals who did not own any interest in the activity) for the year.

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

5. You materially participated in the activity for any 5 (whether or not consecutive) of the 10 preceding tax years. When determining if you materially participated in tax years beginning before 1987 (other than a tax year of a partnership, an S corporation, an estate, or a trust ending after 1986), you materially participated only if you participated for more than 500 hours during the tax year.

6. The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years. When determining if you materially participated for tax years beginning before 1987 (other than a tax year of a partnership, an S corporation, an estate, or a trust ending after 1986), you materially participated only if you 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, you participated in the activity on a regular, continuous, and substantial basis during the tax year.

You did not materially participate in the activity under this seventh test, however, if you participated in the activity for 100 hours or less during the year. Your participation in managing the activity does not count

in determining whether you materially participated under this test if:

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

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

Special rules for limited partners.—If you owned your interest in an activity as a limited partner, you generally **did not** materially participate in the activity. You **did** materially participate in the activity, however, if you met material participation tests 1, 5, or 6 above for the tax year.

You are not treated as a limited partner, for purposes of the material participation tests, however, if you were a general partner in the partnership at all times during the partnership's tax year ending with or within your tax year (or, if shorter, during the portion of the partnership's tax year in which you directly or indirectly owned your limited partner interest).

Special rules for certain retired or disabled farmers and surviving spouses of farmers.— Certain retired or disabled farmers and surviving spouses of farmers are treated as materially participating in a farming activity if the real property used in the activity would meet the estate tax rules for special valuation of farm property passed from a qualifying decedent. See Temporary Regulations section 1.469-5T(h)(2).

Estates and trusts.—The passive loss limitations apply in figuring the distributable net income and taxable income of an estate or trust. See Temporary Regulations section 1.469-1T(b)(2) and (3). The rules for determining material participation for this purpose have not yet been issued.

Grouping Your Activities

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. Reliance between or among the activities.

Example. You have 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 your 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 you choose a grouping under these rules, you 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 your activities if your grouping fails to reflect one or more appropriate economic units and one of the primary purposes of your grouping is to avoid 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 you hold 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, S corporations, and 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 partnerships 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.— You may treat the disposition of substantially all of an activity as a separate activity if you 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 your net income or net loss from all passive activities or any passive activity. For example, if your passive activity is reported on Schedule C, C-EZ, E, or F, and the activity has no prior year unallowed losses or any gain or loss from the disposition of assets or an interest in the activity, take into account only the passive activity income and passive activity deductions from the activity in determining the amount to enter on Form 8582 and the worksheets.

If you own an interest in a passive activity through a partnership or an S corporation, the partnership or S corporation will generally provide you with the net income or net loss from the passive activity. If, however, the partnership or S corporation is required to state an item of gross income or deduction separately to you, and the gross income or deduction is passive activity gross income or a passive activity deduction (respectively), you must include that amount in figuring the net income or net loss entered on Form 8582 and the worksheets.

Caution: *The partnership or S corporation does not have a record of any prior year unallowed losses from the passive activities of the*

partnership or S corporation. If you had prior year unallowed losses from this activity, they can be found in column (c) of your 1994 Worksheet 4.

Passive Activity Income

In determining your overall gain or loss from all passive activities or any passive activity, take into account only passive activity income. Do not enter income that is not passive activity income on Form 8582 or the worksheets. 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 section 163(d)(5)). See Temporary Regulations section 1.469-2T(c)(3).
- Alaska Permanent Fund dividends.
- Personal service income, including salaries, wages, commissions, self-employment income from trade or business activities in which you materially participated for the tax year, deferred compensation, taxable social security and other retirement benefits, and payments from partnerships to partners for personal services. 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.
- Income from an oil or gas property if you 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).
- Any income from intangible property if your personal efforts significantly contributed to the creation of the property.
- Any 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** on page 7.

- Overall gain from any interest in a publicly traded partnership.
- State, local, and foreign income tax refunds.
- Income from a covenant not to compete.
- 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

In determining your overall gain or overall loss from all passive activities or any passive activity, take into account only passive activity deductions. Do not take into account deductions that are not 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 your entire interest in a passive activity. See **Dispositions** on page 7 for the treatment of losses upon certain dispositions of your 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.
- Interest expense, other than interest expense properly allocable under Temporary Regulations section 1.163-8T to passive activities (e.g., qualified home mortgage interest and capitalized interest expense are not passive activity deductions).
- Losses from dispositions of property that produce portfolio income or property held for investment.
- State, local, and foreign income taxes.

- Miscellaneous itemized deductions that may be disallowed under section 67.
- Charitable contribution deductions.
- Net operating loss deductions, percentage depletion carryovers under section 613A(d), and capital loss 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.
- The deduction allowed under section 164(f) for one-half of self-employment taxes.

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 below. If during the tax year you received net income from any sources described below (either directly or through a partnership or an S corporation), see Pub. 925 to find out how to report 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 (defined on page 4) in which you participated for more than 100 hours during the tax year and 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 a nonpassive activity.
- 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 8582 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 you would normally use; do not enter the amounts on Form 8582.

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 8582 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 net income 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 you disposed of your entire interest in a passive activity or a former passive activity to an unrelated person in a fully taxable transaction during the tax year, your losses allocable to the activity for the year are not limited by the passive loss rules. A fully taxable transaction is a transaction in which you recognize all your realized gain or loss.

If you are using the installment method to report this kind of disposition, to figure the loss for the current year that is not limited by the passive loss rules, multiply your overall loss (which **does not** include losses allowed in prior years) by the following fraction:

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

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 you completely dispose of your entire interest in a passive activity or a former passive activity, you may have to report net income or loss and prior year unallowed losses from the activity. All the net income and losses are reported on the forms and schedules you normally use.

Combine any income and losses (including any prior year unallowed losses) from the activity for the tax year to see if you have an overall gain or loss. If you have an overall gain from a passive activity and you have other passive activities to report on Form 8582, include the income, losses, and prior year unallowed losses on Worksheet 1 or 2. If this is your only passive activity or a former passive activity, report any income and losses (including any prior year unallowed losses) on the forms and schedules you normally use and do not include the income or losses on the worksheets or Form 8582.

If you have an overall loss when you combine the income and losses, do not use the worksheets or Form 8582 for the activity. Any losses (including prior year unallowed losses) are allowed in full. Report the income and losses on the forms and schedules you normally use.

If you must figure modified adjusted gross income for line 6 of Form 8582, the overall loss from this activity is a nonpassive loss and must be used when figuring modified adjusted gross income. This is because an overall loss from an entire disposition of a passive activity is a nonpassive loss when there is an aggregate loss from all other passive activities.

Example 1: Activity with overall gain

You sell your entire interest in a rental property in which you actively participated at a gain of \$15,525. \$7,300 of the gain is section 1231 gain (Form 4797, Part I) and \$8,225 is ordinary recapture income (Form 4797, Part II). The total loss you would report on line 23 of Schedule E (Form 1040) is (\$15,450). This includes a current year (\$2,800) net loss, and a (\$12,650) prior year unallowed loss.

If you had other passive activities reportable on Form 8582, you would make the following entries on Worksheet 1. You would enter the

\$15,525 gain on the disposition in column (a), the current year loss of (\$2,800) in column (b), and the prior year unallowed loss of (\$12,650) in column (c).

Example 2: Activity with overall loss

You sell your entire interest in a limited partnership and this is your only passive activity. You have a current year Schedule E loss of (\$3,330), a Schedule E prior year unallowed loss of (\$1,115), and a Schedule D gain of \$2,000 from the sale of your interest in the partnership.

Because there is an overall loss of (\$2,445) after combining the gain and losses, none of the amounts are entered on Worksheet 2 or on Form 8582.

The net loss plus the prior year unallowed loss (\$3,330 + \$1,115 = \$4,445) is entered on Schedule E, Part II, column (i), and the \$2,000 gain on the sale is entered on Schedule D, in either Part I or Part II, depending on how long the partnership interest was held.

Specific Instructions

Part I

Worksheet 1

Individuals and qualifying estates who actively participated in rental real estate activities should use Worksheet 1 and include the income or loss from those activities on lines 1a through 1d of Form 8582. Use Worksheet 2 to figure the amounts to enter on lines 2a, 2b, and 2c if you did not actively participate in a rental real estate activity.

Caution: Do not enter a prior year unallowed loss in column (c) of Worksheet 1 unless you actively participated in the activity in both the year the loss arose and the current tax year. If you did not actively participate in both years, enter the prior year unallowed loss in column (c) of Worksheet 2.

Married individuals who are filing separate returns and did not live apart from their spouse at all times during the tax year do not qualify under the active participation rule and should use Worksheet 2 instead of Worksheet 1. To take advantage of the \$25,000 allowance, married individuals must file a joint return.

See Pub. 925 for an example showing how to complete the worksheet.

Column (a).—Enter the net income from each activity. For example, if a Schedule C activity has current year

profit of \$5,000 and a Form 4797 gain of \$2,000, enter \$7,000 in column (a). Enter the total of column (a) on line 1a of Form 8582.

Column (b).—Enter the net loss for each activity. For example, if a Schedule E rental activity has a current year loss of (\$4,500) on line 22 of Schedule E and a current year Form 4797 loss of (\$1,000), enter (\$5,500) in column (b). Do not enter any prior year unallowed losses in this column. Enter the total of column (b) on line 1b of Form 8582.

Column (c).—Enter the prior year unallowed losses for each activity. These amounts can be found on Worksheet 4, column (c), of your 1994 Form 8582. Enter the total of column (c) from your 1995 Worksheet 1 on line 1c of Form 8582.

Columns (d) and (e).—Combine income and losses in columns (a) through (c) for each activity and enter any overall gain for the activity in column (d) or any overall loss for the activity in column (e). Do not enter amounts from columns (d) and (e) on Form 8582. These amounts will be used when Form 8582 is completed to figure the loss allowed for the current year.

Worksheet 2

Use Worksheet 2 for passive trade or business activities, for passive rental real estate activities that do not qualify for the special allowance, and for rental activities other than rental real estate activities.

Pub. 925 has examples of a completed Form 8582 and worksheets.

Column (a).—Enter the net income for each activity. (See the example included in the instructions under column (a) for Worksheet 1, above.) Enter the total of column (a) on line 2a of Form 8582.

Column (b).—Enter the net loss for each activity. (See the example included in the instructions under column (b) of Worksheet 1, above.) Enter the total of column (b) on line 2b of Form 8582.

Column (c).—Enter the prior year unallowed losses for each activity. These amounts can be found on Worksheet 4, column (c), of your 1994 Form 8582. Enter the total of column (c) from your 1995 Worksheet 2 on line 2c of Form 8582.

Columns (d) and (e).—Combine income and losses in columns (a) through (c) for each activity and enter any overall gain for the activity in column (d) or any overall loss for the activity in column (e). Do not enter amounts from columns (d) and (e) on

Form 8582. These amounts will be used when Form 8582 is completed to figure the loss allowed for the current year.

Line 3.—If line 3 shows net income or zero, all your losses are allowed, including any prior year unallowed losses entered on line 1c or 2c. Do not complete Form 8582. Take the losses to the form or schedule you normally report them on.

Part II

Enter all numbers in Part II as positive amounts (i.e., greater than zero).

Examples:

1. Line 1d has a loss of \$47,000 and line 3 has a loss of \$42,000. Enter \$42,000 as a positive number on line 4.

2. Line 4 has a loss of \$42,000 and line 8 is \$25,000. Enter \$25,000 as a positive number on line 9.

Line 5.—Married persons filing separate returns who lived apart at all times during the year should enter \$75,000 on line 5 instead of \$150,000. Married persons filing separate returns who lived together at any time during the year are not eligible for the special allowance. They must enter zero on line 9 and go to line 10.

Line 6.—To figure **modified adjusted gross income** for this line, combine all the amounts you would use to figure adjusted gross income except do not take into account:

- Passive income or loss included on Form 8582;
- Any rental real estate loss allowed under section 469(c)(7) to real estate professionals (defined under **Activities That Are Not Passive Activities** on page 2).
- Any overall loss from a PTP;
- The taxable amount of social security and tier 1 railroad retirement benefits;
- The deduction allowed under section 219 for contributions to IRAs and certain other qualified retirement plans;
- The deduction allowed under section 164(f) for one-half of self-employment taxes, **or**
- The exclusion from income of interest from series EE U.S. savings bonds used to pay higher education expenses.

Include portfolio income or expenses that are clearly and directly allocable to portfolio income in the modified adjusted gross income computation. Any income that is treated as nonpassive income is included in the computation of

modified adjusted gross income. For example, overall gain from a publicly traded partnership and net income from an activity or item of property subject to the recharacterization of passive income rules is nonpassive income. In addition, an overall loss from the entire disposition of a passive activity is not included on Form 8582. Instead, the overall loss is a nonpassive loss and must be included in the computation of modified adjusted gross income.

Example. If your adjusted gross income on line 31 of Form 1040 is \$92,000, and you had taxable social security benefits of \$5,500 on line 20b, your modified adjusted gross income would be \$86,500 (\$92,000 – \$5,500).

Line 8.—Do not enter more than \$12,500 on line 8 if you are married filing a separate return and you and your spouse lived apart at all times during the year. Married persons filing separate returns who lived together at any time during the year are not eligible for the special allowance. They must enter zero on line 9 and go to line 10.

Part III

Line 11.—Use the worksheets on Form 8582 and the following instructions for those worksheets to figure the unallowed loss to be carried forward and the allowed loss to report on the forms and schedules for 1995. Worksheets 1 and 2, columns (d) and (e), will show whether an activity had an overall gain or loss. If you have activities that show overall gain in column (d) of Worksheet 1 or 2, report all the income and losses listed in columns (a), (b), and (c) for those activities on the proper forms and schedules.

If you have activities in Worksheet 1 or 2 that show an overall loss in column (e), you will have to allocate the allowed loss on line 11 of Form 8582 to those activities by completing Worksheets 3, 4, and 5 or 6.

Start with Worksheet 3 if you have any activities in Worksheet 1 with an overall loss in column (e) and an amount on line 9 of Form 8582. If you do not have activities with an overall loss in Worksheet 1 or line 9 does not have an entry, start with Worksheet 4 for any activities in Worksheet 1 or 2 that show an overall loss in column (e).

Worksheet 3

Use Worksheet 3 if you have activities in Worksheet 1 with an overall loss in column (e) and an amount on line 9 of Form 8582.

Column (a).—Enter the overall loss from column (e) of Worksheet 1 for each activity.

Column (b).—Divide each of the individual losses shown 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 line 9 of Form 8582 by each of the ratios in column (b) and enter the results in column (c). The total of column (c) should be the same as line 9 of Form 8582.

Column (c) total is the same as column (a) total.—If the total losses in column (c) are the same as the total losses in column (a), all the amounts in columns (a), (b), and (c) of Worksheet 1 should be reported on the proper forms and schedules. The losses in Worksheet 1 are allowed in full and are not carried over to Worksheet 4. Complete Worksheet 4 only if you have activities with overall losses in column (e) of Worksheet 2.

Column (c) total is less than column (a) total.—If the total losses in column (c) are less than the total losses in column (a), complete column (d).

Column (d).—Subtract column (c) from column (a) and enter the results in this column. Also enter on Worksheet 4 the name of the activities and the form or schedule on which the loss is to be reported. Enter the amounts from column (d) of this worksheet in column (a) of Worksheet 4. Also include in Worksheet 4 any activities from Worksheet 2 that have an overall loss in column (e) of that worksheet.

Worksheet 4

Complete Worksheet 4 if you have an overall loss in column (e) of Worksheet 2 or losses in column (d) of Worksheet 3 (column (e) of Worksheet 1, if you did not have to complete Worksheet 3).

Column (a).—Enter the amounts, if any, from column (d) of Worksheet 3 (column (e) of Worksheet 1 if you did not have to complete Worksheet 3). Also enter the losses, if any, shown in column (e) of Worksheet 2.

Column (b).—Divide each of the individual losses shown 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).—Complete the following computation:

- A. Enter line 3 of Form 8582 . . . _____
B. Enter line 9 of Form 8582 . . . _____
C. Subtract line B from line A . . . _____

Multiply line C by the ratios in column (b) and enter the results in column (c).

Use Worksheet 5 for the activities listed in Worksheet 4 if all the loss from the same activity is reported on one form or schedule. For example, use Worksheet 5 if all the loss from the activity is reported on Schedule E, even though part of the loss may be a current year Schedule E loss and part of it may be from a Schedule E prior year unallowed loss.

If you have losses from the same activity that are to be reported on two or more different schedules, use Worksheet 6 instead of Worksheet 5 for those activities. For example, if you have a Schedule C loss and you also have a Form 4797 loss from the sale of assets from the Schedule C activity, use Worksheet 6 instead of Worksheet 5.

Worksheet 5

Column (a).—Enter the activities shown in Worksheet 4 if all the loss from the same activity is to be reported on one form or schedule. The loss to enter in column (a) of this worksheet is the net loss plus the prior year unallowed loss for each activity you enter in this worksheet. This amount can be found by adding the losses in columns (b) and (c) of Worksheets 1 and 2.

Column (b).—Enter the amounts from column (c) of Worksheet 4 for the activities listed in this worksheet. These are your **unallowed losses for 1995**. Keep a record of these amounts so the losses can be used to figure your passive activity loss next year.

Column (c).—Subtract column (b) from column (a). These are the **losses allowed for 1995**. The amounts in this column should be reported on the form or schedule you normally use.

See the forms and schedules listed under **Reporting Allowed Losses on the Forms and Schedules** on page 10. Pub. 925 also has an extensive example of how to report passive income and losses on the forms and schedules.

Worksheet 6

Use Worksheet 6 if you have losses from the same activity that are reported on two or more different forms and schedules. Worksheet 6 will allocate the loss allowed and unallowed for the activity and the loss allowed on the different forms or schedules used to report the losses. Only the losses that would cause a difference in the tax liability if they were reported on a different form or schedule are kept separate. Any

losses from the following forms or schedules should be kept separate:

- Schedules C, D (Parts I and II), E, and F.
- Forms 4684 (Section B), 4797 (Parts I and II), and 4835.

Make a copy of Worksheet 6 to use for each additional activity for which you have losses reported on two or more different forms or schedules. When making entries in Worksheet 6, enter the name of the form or schedule on the line above line 1a.

Line 1a, column (a).—Enter the net loss plus any prior year unallowed loss from the activity that goes on the same form, or in the case of Schedule D and Form 4797, the same part (Part I or Part II).

Line 1b, column (a).—Enter any net income from the activity that goes on the same form or schedule as the loss on line 1a, column (a). For example, you entered a prior year unallowed loss from Form 4797, Part I, on line 1a and this year you have a current year gain that is also reported on Form 4797, Part I. Enter the gain on line 1b, column (a). If the activity did not have a Form 4797, Part I gain, enter zero on line 1b, column (a).

Line 1c, column (b).—Subtract line 1b, column (a) from line 1a, column (a), and enter the result in column (b). If line 1b, column (a), is more than line 1a, column (a), enter zero in column (b).

Column (c).—Divide each of the losses entered in column (b) by the total of column (b) and enter the ratio in this column. The total of this column should be 1.00.

Column (d).—Find the unallowed loss for this activity in Worksheet 4, column (c), and multiply that unallowed loss by the ratio in column (c) of this worksheet. If you have entries in column (b) of this worksheet that show zero, also enter zero for that form or schedule in this column.

The amount in this column is the **unallowed loss for 1995**. Keep a record of this worksheet so that you can use the losses to figure your passive activity loss next year.

Column (e).—Subtract the amount in column (d) from the loss entered on line 1a, column (a). This is the **allowed loss for 1995** to be entered on the forms or schedules. The forms and schedules you report on should show the losses from this column and the income, if any, for that activity from column (a) of Worksheet 1 or 2.

See the forms and schedules listed under **Reporting Allowed Losses on the Forms and Schedules** below. Pub. 925 also has an extensive

example of how to report passive income and losses on the forms and schedules.

Reporting Allowed Losses on the Forms and Schedules

Line 3 is income.—If line 3 of Form 8582 shows net income or zero, all the losses in columns (b) and (c) of Worksheets 1 and 2 are allowed in full. Report the income and losses in columns (a), (b), and (c) of Worksheets 1 and 2 on the forms and schedules normally used.

Line 11 is the same as the total of lines 1b, 1c, 2b, and 2c.—If this is the case, all the losses in columns (b) and (c) of Worksheets 1 and 2 are allowed in full. Report the income and losses in columns (a), (b), and (c) of Worksheets 1 and 2 on the forms and schedules normally used.

Columns (a) and (c) of Worksheet 3 are the same amount.—If this is the case, all the losses in columns (b) and (c) of Worksheet 1 are allowed in full. Report the income and losses in columns (a), (b), and (c) of Worksheet 1 on the forms and schedules normally used.

Losses allowed in column (c) of Worksheet 5.—The amounts shown in column (c) of Worksheet 5 are the losses allowed for 1995 for the activities listed in that worksheet. Report the loss allowed from column (c) of Worksheet 5 and the income, if any, for that activity shown in column (a) of Worksheet 1 or 2, on the form or schedule normally used.

Losses allowed in column (e) of Worksheet 6.—The amounts shown in column (e) of Worksheet 6 are the losses allowed for 1995 for the activity listed in that worksheet. Report the losses allowed from column (e) of Worksheet 6 and the income, if any, for that activity shown in column (a) of Worksheet 1 or 2, on the forms or schedules normally used.

Schedules C and F, and Form 4835.—Enter on the net profit or loss line of your schedule or form, the allowed passive activity loss from the worksheet. To the left of the entry space write "PAL."

If the net profit or loss line on your form or schedule shows net profit for the year, reduce the net profit by the allowed loss from Worksheet 5 or 6 and enter the result on the net profit or loss line. For example, Schedule C shows net profit for the year of \$5,000. The activity also has a Form 4797 gain of \$2,500 and a prior year unallowed Schedule C loss of (\$6,000). The loss allowed for 1995 is (\$6,000). Line 31 would show a net

loss of (\$1,000). To arrive at this answer, subtract the loss allowed for the year (\$6,000) from the net profit for the year (\$5,000). To the left of the entry space, write "PAL."

See Schedule D and Form 4797 instructions below if you also had passive gains and losses from the sale of assets or an interest in the passive activity.

Schedule E, Part I.—Enter the allowed loss from the worksheet on line 23 of Schedule E. An activity that has net profit for the year and prior year unallowed losses will have net profit on line 22 and the allowed loss on line 23. The allowed loss on line 23 will include the loss allowed to the extent of the net profit. Line 24 of Schedule E will show total net profit and line 25 will show total losses allowed (both passive and nonpassive). Line 26 will show the total net profit or loss.

Schedule E, Parts II and III.—Any net income shown on your Schedule K-1 that is passive income should be entered as passive income in the appropriate column of Schedule E, Part II or III. Enter the passive loss allowed from Worksheet 5 or 6 in the appropriate column for passive losses. The passive losses allowed include the loss allowed to the extent of any net income from the activity. See Schedule D and Form 4797 instructions below if you also had passive gains or losses from the sale of assets or an interest in the passive activity.

Form 4684, Section B.—Any passive activity gain from Form 4684 remains unchanged. It was used on Form 8582 to determine allowable passive activity losses. If you did not have passive activity losses on Form 4684, complete Form 4684 and follow the instructions for that form regarding where to report the gain.

If you had passive activity losses from Form 4684, cross through the amount you first entered on line 31, 32, 38a, 38b, or 39 and show the allowed loss from the worksheet. To the left of the entry space write "PAL."

Schedule D and Form 4797.—If you sold assets from a passive activity or if you sold an interest in your passive activity, all gains from the activities should be shown on the appropriate line of Schedule D or Form 4797. Identify the gain as "From passive activity." Enter any allowed losses for Schedule D or Form 4797 on the appropriate line and to the left of the entry space write "PAL."

Entire disposition with an overall loss.—If you had an entire disposition of your interest in a passive activity

and that activity had an overall loss, none of the gains, if any, or losses should have been entered on Form 8582 or the worksheets. However, all the gains and losses should be reported on the forms or schedules you normally use. To the left of the entry space, write "Entire disposition of passive activity."

Entire disposition with an overall gain.—Gains and losses from this activity were included on Form 8582 so that the gains could offset other passive activity losses. Report all the gains and losses on the forms and schedules you normally use and to the left of the entry space, write "Entire disposition of passive activity."

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 his or her 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 timeframe and with the regularity and continuity that the existence of a market maker would provide.

Special Instructions for PTPs

Section 469(k) provides that the passive activity limitations must be applied separately to items from each PTP. Losses from passive activities held through a PTP generally can only

be used to offset income or gain from passive activities of the same PTP.

Passive activity loss rules for partners in PTPs.—Do not report passive income, gains, or losses from a PTP on Form 8582. Instead, use the following rules to figure and report on the proper form or schedule your income, gains, and losses from passive activities you held through each PTP you owned during the tax year:

1. Combine any current year income, gains and losses, and any prior year unallowed losses to see if you have an overall loss from the PTP. Include only the same types of income and losses you would include in figuring your net income or loss from a non-PTP passive activity. See **Passive Activity Income and Deductions** on page 6.

2. If you have an overall gain, the net gain portion (total gain minus total losses) is nonpassive income. On the form or schedule you normally use, report the net gain portion as nonpassive income and the remaining income and the total losses as passive income and loss. To the left of the entry space, write "From PTP." It is important to identify the nonpassive income because the nonpassive portion is included in modified adjusted gross income for purposes of figuring on Form 8582 the special allowance for active participation in a non-PTP rental real estate activity. In addition, you may be able to include the nonpassive income in investment income when figuring your investment interest expense deduction. For details, get **Form 4952**, Investment Interest Expense Deduction.

Example. If you have Schedule E income of \$8,000, and a Form 4797 prior year unallowed loss of \$3,500, from the passive activities of a particular PTP, you have a \$4,500 overall gain (\$8,000 – \$3,500). On Schedule E, Part II, report the \$4,500 net gain as nonpassive income in column (k). In column (h), report the remaining Schedule E gain of \$3,500 (\$8,000 – \$4,500). On the appropriate line of Form 4797, report the prior year unallowed loss of \$3,500. Write "From PTP" to the left of each entry space.

3. If you have an overall loss (but did not dispose of your entire interest in the PTP to an unrelated person in a fully taxable transaction during the year), the losses are allowed to the extent of the income and the excess loss is carried forward to use in a future year when you have income to offset it. Report as a passive loss on

the schedule or form you normally use the portion of the loss equal to the income. Report the income as passive income on the form or schedule you normally use.

Example. You have a Schedule E loss of \$12,000 (current year losses plus prior year unallowed losses) and Form 4797 gain of \$7,200. Report the \$7,200 gain on the appropriate line of Form 4797. On Schedule E, Part II, report \$7,200 of the losses as a passive loss in column (g). Carry forward to 1996 the unallowed loss of \$4,800 (\$12,000 – \$7,200).

If you have unallowed losses from more than one activity of the PTP or from the same activity of the PTP that must be reported on different forms, allocate the unallowed losses on a pro rata basis to figure the amount allowed from each activity or on each form.

Tax tip: To allocate and keep a record of the unallowed losses, use Worksheets 4, 5, and 6 of Form 8582. List each activity of the PTP in Worksheet 4. Enter the overall loss from each activity in column (a). Complete column (b) of Worksheet 4 according to its instructions. Multiply the total unallowed loss from the PTP by each ratio in column (b) and enter the result in column (c) of Worksheet 4. Then complete Worksheet 5 if all of the loss from the same activity is to be reported on one form or schedule. Use Worksheet 6 instead of Worksheet 5 if you have more than one loss to be reported on different forms or schedules for the same activity. Enter the net loss plus any prior year unallowed losses in column (a) of Worksheet 5 (or Worksheet 6 if applicable). The losses in column (c) of Worksheet 5 (column (e) of Worksheet 6) are the allowed losses to report on the forms or schedules. Report both these losses and any income from the PTP on the forms and schedules you normally use.

4. If you have an overall loss and you disposed of your entire interest in the PTP to an unrelated person in a fully taxable transaction during the year, your losses (including prior year unallowed losses) allocable to the activity for the year are not limited by the passive loss rules. A fully taxable transaction is one in which you recognize all your realized gain or loss. Report the income and losses on the forms and schedules you normally use.

Note: For rules on the disposition of an entire interest reported using the installment method, see **Disposition of an Entire Interest** on page 7.