

1991



Department of the Treasury
Internal Revenue Service

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. . . . 25 hrs., 21 min.

Learning about the law or the form 5 hrs., 22 min.

Preparing and sending the form to the IRS . . . 6 hrs., 1 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form more simple, 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.

Changes To Note

- For tax years 1987 through 1990, the passive activity loss and credit limitations were phased in by allowing a declining percentage of the losses and credits from pre-enactment interests in passive activities. Starting in 1991, passive activity losses are allowed only to the extent of passive activity income (and, for closely held corporations, net active income). Passive activity credits are allowed only to the extent of the tax attributable to net passive income (and, for closely held corporations, the tax attributable to net active income).
- The Revenue Reconciliation Act of 1990 added the enhanced oil recovery credit to the general business credit. This credit is subject to the passive activity credit rules.

General Instructions

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 of 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 of its passive activities exceed the sum of the total income from all of 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.

There are two kinds of passive activities: trade or business activities in which the corporation did not materially participate for the tax year, and rental activities regardless of its participation. See **Trade or Business Activities** on page 3 and **Rental Activities** on page 4.

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

Who Must File

Form 8810 is filed by personal service corporations and closely held corporations that have losses or credits from passive activities. 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.

Meaning of Terms

Except as otherwise indicated, the following terms in these instructions have the following meanings:

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 Temporary Regulations section 1.469-1T(f)(4).

Coordination With Other Limitations

Losses from passive activities generally are subject to other applicable limitations (for example, 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.

Identifying The Corporation's Activities

Generally, each undertaking the corporation owns is a separate activity. The corporation can own an undertaking either directly or through a partnership, an estate, or a trust, but not through another corporation.

An undertaking includes all the business or rental operations the corporation owns at the same location either directly or through the same partnership, estate, or trust. Operations are conducted at the same location if they are conducted in the same physical structure or within close proximity of one another. Operations not actually conducted at a fixed location are treated as conducted at the location with which they are most closely associated under all the facts and circumstances. For example, if a business sends employees from a central office to perform services at customers' homes, the operations are treated as conducted at the central office. If the corporation conducts all its business (that is, nonrental) operations at the same location directly or through one entity, it has only one undertaking and one activity.

If the corporation owns an undertaking that conducts both rental and nonrental operations, it must treat the two types of operations as two separate undertakings unless: (a) the rental operations, if treated as a separate activity, would not be a rental activity (see **Rental Activities** on page 4); or (b) one type of operation predominates over the other (that is, one type of operation produces more than 80% of the combined undertaking's gross income).

Once the corporation identifies its undertakings, it must treat each undertaking as a separate activity unless one of the following rules requires or permits it to combine undertakings into a larger activity.

Trade or business undertakings.—The corporation generally must combine trade or business undertakings into a larger activity if the undertakings are similar and commonly controlled. For details, see Temporary Regulations sections 1.469-4T(f) and (j). Trade or business undertakings include all nonrental undertakings except professional service undertakings (described in the next paragraph) and oil or gas wells treated as separate undertakings under Temporary Regulations section 1.469-4T(e). Trade or business activities that constitute an integrated business may have to be combined into a larger activity under Temporary Regulations section 1.469-4T(g).

Professional service undertakings.—Professional service undertakings

principally provide services in the fields of health, law, engineering, architecture, accounting, actuarial science, the performing arts, or consulting. Generally, the corporation must combine its interests in professional service undertakings into a single activity if the undertakings provide services in the same field or earn more than 20% of their gross income from serving the same customers, or if the undertakings are controlled by the same interests. For details, see Temporary Regulations section 1.469-4T(h).

The corporation can elect to treat combined nonrental undertakings as separate activities for purposes other than determining participation in activities. To make this election, the corporation must attach to its return a statement that: (a) gives its name, address, and employer identification number; (b) declares that the election is being made under Temporary Regulations section 1.469-4T(o); (c) identifies the undertaking it is treating as a separate activity; and (d) identifies the rest of the activity from which it is separating the undertaking.

If undertakings the corporation acquired in 1991 would otherwise be combined into a larger activity, the corporation must attach this statement to its 1991 return or it will not be able to treat the undertakings as separate activities for 1991 or any later year. For details, see Temporary Regulations section 1.469-4T(o).

If undertakings the corporation acquired in a previous year were combined into a larger activity on a prior year tax return, the larger activity cannot be divided into separate activities in 1991 or any later year.

Rental real estate undertakings.—A rental real estate undertaking is a rental undertaking in which at least 85% of the unadjusted basis of the property made available for use by customers is real property. In general, each rental real estate undertaking is a separate activity. However, the corporation may combine separate rental real estate undertakings into the same activity. Under certain circumstances, it may also divide a single rental real estate undertaking into separate undertakings. For details, see Temporary Regulations section 1.469-4T(k)(2)(iii). The corporation can then treat each separate undertaking as a separate activity or combine the separate undertakings with other undertakings to identify its real estate activities.

The corporation generally must attach a statement to its return if it combines separate rental real estate undertakings or portions of undertakings into the same activity or divides a single rental real estate undertaking into separate undertakings. If the corporation wants to divide a single rental real estate

undertaking it acquired in 1991 into separate undertakings, it must attach this statement to its 1991 return or it will not be able to treat the undertaking as separate undertakings for 1991 or any later year.

If the corporation divided a single rental real estate undertaking it acquired in a previous year into separate undertakings on a prior year tax return, the undertakings must be treated as separate undertakings in 1991 and any later year.

Furthermore, if the corporation combined rental real estate undertakings it acquired in a previous year into a larger activity on a prior year tax return, the larger activity cannot be divided into separate activities in 1991 or any later year.

Other rental undertakings.—The corporation may not combine or divide its rental undertakings, other than rental real estate undertakings. It must treat each rental undertaking that is not a rental real estate undertaking as a separate activity.

Publicly traded partnerships (PTPs).—The corporation may not combine operations held through a PTP with any other operations it owns, including operations it holds through another PTP. For details, see **Publicly Traded Partnerships (PTPs)** on page 9 and Temporary Regulations section 1.469-4T(n).

Activities of a consolidated group.—If an affiliated group of corporations files a consolidated return, the group must determine its activities and the activities of each member as if the consolidated group were one taxpayer. For details, see Temporary Regulations section 1.469-4T(m).

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. 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 (for example, 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).

3. 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).

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

Trade or Business Activities

An activity is a trade or business activity if the activity:

1. Is not a rental activity; and
2. Involves the conduct of business and rental operations that are not incidental to an activity of holding property for investment.

"Business and rental operations" are endeavors engaged in for profit or for the production of income that satisfy one or more of the following conditions:

1. They involve the conduct of a trade or business (i.e., deductions would be allowable under section 162 if other limitations, such as the passive loss rules, did not apply) or are conducted in anticipation of the endeavors becoming a trade or business;
2. They involve making tangible property available for use by customers; or
3. Research or experimental expenditures in the activity are deductible under section 174 (or would be if you chose to deduct rather than to capitalize them).

Material or Significant Participation

Personal service corporations and closely held corporations materially or significantly participate in an activity of the corporation 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 percent (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 of 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 of 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 (including individuals who did not own any interest in the activity) was substantially all of the participation in the activity of all individuals 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 activity) for the year.

4. The activity is a significant participation activity for the individual for the tax year, and the individual 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 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 of 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.

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 percent (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 Temporary Regulations section 1.469-1T(h)(4) for rules for determining whether a consolidated group materially or significantly participates.

How To Report Income, Deductions, Losses, and Credits From Trade or Business 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 9. See Pub. 925 for how to report income or losses from significant participation passive activities.

If the corporation has credits from passive activities, generally use Worksheet 5 on page 10 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 11 for how to report credits from these activities.

Rental Activities

A rental activity is a passive activity even if the corporation materially participated in the activity.

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 **How To Report Income, Deductions, Losses, and Credits From the Activities** on page 5 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 seven 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 Temporary Regulations section 1.469-1T(e)(3)(iii).

2. The **average period of customer use** (see definition in 1 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 of 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 at all times 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.

How To Report 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** on page 3.) 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** on page 4.

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 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** apply. See the PTP rules on page 9 and **Recharacterization of Passive Income** below.

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 rental activity. If the corporation has credits from rental activities, use Worksheet 5 on page 10 to figure the amount to enter in Part II of Form 8810.

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 compute its passive activity loss, a closely held corporation subtracts both passive activity income and net active income from its passive activity deductions. See the definition of net active income on page 6.

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)) 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. See **Activities That Are Not Passive Activities** on page 2.
- 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 Temporary Regulations section 1.469-2T(c)(6).
- Income treated as income that is not passive activity income under Temporary Regulations section 1.469-2T(f). See **Recharacterization of Passive Income** below.
- Overall gain from any interest in a publicly traded partnership. See **Publicly Traded Partnerships (PTPs)** on page 9.
- 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.

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 Temporary Regulations section 1.469-1T(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) for more information.

- 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 (see **Material or Significant Participation** on page 3 and Pub. 925).
- Rental of property when less than 30% of the unadjusted basis of the property is subject to depreciation under section 167.
- 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.

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 and are to be included on Form 8810. A disposition of less than an entire interest does not trigger the allowance of prior year unallowed losses. Read the instructions for Worksheets 1 and 2 below to see how to make the entries on Form 8810.

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. No basis adjustment may be elected on a partial disposition of the corporation's interest in a passive activity.

The operations the corporation treats as its entire interest in an activity for purposes of this disposition rule may depend on whether it has elected to treat certain nonrental undertakings as separate activities or whether it has treated certain rental real estate undertakings as separate undertakings. See **Identifying the Corporation's Activities** on page 2 and Temporary Regulations sections 1.469-4T(k) and (o).

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, and 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

Part I

Instructions for 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.

Instructions for 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 1990 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.

Lines 1d and 3.—If line 1d or 3 shows net income or zero, all of 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 \$500 of deductions for prior year unallowed repairs. Enter \$1,500 as the deduction for repairs 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 Temporary Regulations section 1.469-2T(c)(2)(iii)(F).

• Gross income from certain oil or gas properties treated under Temporary Regulations section 1.469-2T(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.

Net active income includes an overall loss from a passive activity if there is a fully taxable disposition of an entire interest in the passive activity. The overall loss is included to the extent that it exceeds net passive income. If there is a net passive loss (line 1d of Form 8810 is a loss), include all of it.

Line 4.—Use Worksheets 3 and 4 on page 8 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 1991. 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).

Instructions for Worksheet 3

Use Worksheet 3 if you have activities in Worksheet 2 with an overall loss in column (e) 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.

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

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

Note: If there were prior year unallowed losses from 1990, include the unallowed prior year losses on the appropriate line along with any current year deduction or loss for that line. See the example under the instructions for lines 1d and 3 on page 6. 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 of 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 on page 8 to figure the allowed deductions and losses.

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
Totals. Enter on lines 1a, 1b, and 1c of Form 8810 ▶					

Instructions for 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

Gross receipts	\$100,000
Deductions	120,000
Net loss	(\$20,000)

Schedule D

Gain	\$1,000
Loss	(2,000)
Net loss	(\$1,000)

Form 4797

Gain	\$5,000
Loss	(2,000)
Net gain	\$3,000

\$17,143 of the unallowed loss would be allocated to Form 1120 deductions and \$857 to the Schedule D loss. The \$5,000 gain and the loss of \$2,000 are both reported on Form 4797. Worksheet 4 will 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, line 6i of Worksheet 1 shows current year depreciation for the activity of \$2,200. 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.

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 all of the ratios should 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—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.)
Totals		1.00	

Worksheet 4—Allowed Deductions and Losses

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 to officers				
c. Salaries and wages				
d. Repairs				
e. Bad debts				
f. Rents				
g. Taxes				
h. Interest				
i. Depreciation				
j. Depletion				
k. Advertising				
l. Other deductions				
Total Form 1120 deductions ▶		1.00		
2 Schedule D losses				
3 Form 4797 losses				
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 to officers				
c. Salaries and wages				
d. Repairs				
e. Bad debts				
f. Rents				
g. Taxes				
h. Interest				
i. Depreciation				
j. Depletion				
k. Advertising				
l. Other deductions				
Total Form 1120 deductions ▶		1.00		
2 Schedule D losses				
3 Form 4797 losses				

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.

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 compute 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 an entire disposition), 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

Passive Activity Credits

Part II of Form 8810 is used to determine 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;
- Disabled access credit;
- Enhanced oil recovery credit;
- Possessions tax credit;
- Orphan drug credit; and
- Credit for fuel produced from a nonconventional source.

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. See **Rental Activities** on page 4.

Current Year Credits

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 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. Any prior year unallowed credits would be entered in column (b). Make a separate line entry for a prior year unallowed credit if it is from a different activity or if it is a different type of credit.

Form 5735, Possessions Corporation Tax Credit Allowed Under Section 936.—Complete Parts I and II. Enter the portion of the credit attributable to passive activities 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 passive credit from line 4 in column (a) of Worksheet 5.

Credit for fuel produced from a nonconventional source.—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.

Prior Year Unallowed Credits

In computing this year's passive activity credit, the corporation must take into account any credits from passive activities disallowed for prior years and carried forward to this year. Enter the prior year unallowed credits from Worksheet 6 of the 1990 Form 8810 instructions in column (b) of the 1991 Worksheet 5.

Computation of 1991 Passive Activity Credits

Lines 5a and 5b.—Use Worksheet 5 to figure the amounts to enter on lines 5a and 5b of Form 8810. Line 5a is used for current year passive activity credits and line 5b is used for prior year unallowed credits. The prior year unallowed credits can be found in column (c) of Worksheet 6 in the corporation's 1990 Form 8810 instructions.

Worksheet 5—For Form 8810, Lines 5a and 5b

Name of Activity	From Form	Current Year Credits	Prior Year Unallowed Credits	Total Credits
		(a) Credits line 5a	(b) Credits line 5b	(c) Add columns (a) and (b)
Totals. Enter on lines 5a and 5b of Form 8810				

Line 7.—If any of the following apply, enter zero on line 7 and do not complete Part I or Part II of the computation below. Enter zero on line 7 if:

- The corporation is a personal service corporation with a loss on line 1d of Form 8810; **or**
- The corporation is a personal service corporation with net passive income on line 1d of Form 8810 and the corporation had an overall loss from the entire disposition of a passive activity that was equal to or greater than the net income on line 1d; **or**
- The corporation is a closely held corporation with a loss on line 1d of Form 8810 and the corporation had no net active income; **or**
- The corporation is a closely held corporation with net passive income on line 1d of Form 8810, and had an overall loss from an entire disposition that was equal to or greater than the amount on line 1d of Form 8810, and the corporation had no net active income.

Part I below is used by personal service corporations and closely held corporations with net passive income.

Part II below is used by closely held corporations that have net active income. See the line 2 instructions on page 6 for the definition of net active income. If the corporation has both net passive income and net active income, complete Part I and Part II and enter the amount from line Q on line 7 of Form 8810.

Note: When using taxable income in the following computation, it is not necessary to recompute items based on taxable income, such as the contributions deduction, dividends-received deduction, and the net operating loss deduction.

Use the applicable tax rates in section 11 when computing the tax attributable amounts. Also see how to compute tax in the instructions for the tax return filed.

Computation for Line 7

Part I—Computation of Tax Attributable to Net Passive Income

A. Income tax before credits from Form 1120 (Schedule J, line 3) _____

- B. Taxable income from Form 1120 _____
- C. Net passive income. See instructions below _____
- D. Subtract line C from line B. If -0- or less, enter -0- here and on lines E and F _____
- E. Tax attributable to line D. See instructions below _____
- F. Tax attributable to net passive income. Subtract line E from line A. Closely held corporations that do not have net active income and personal service corporations enter the amount here and on line 7 of Form 8810 _____

Part II—Computation of Tax Attributable to Net Active Income

- G. Enter amount from line E above if you completed Part I. Otherwise, enter income tax before credits from Form 1120 (Schedule J, line 3) _____
- H. Taxable income from Form 1120 _____
- I. Net active income _____
- J. Net passive income or loss. See instructions below _____
- K. Add lines I and J. If less than -0-, enter as a negative amount _____
- L. Subtract line K from line H. If -0- or less, enter -0- here and on line M _____
- M. Tax attributable to line L _____
- N. Subtract line M from line G. If -0- or less, enter -0- here and on line P _____
- O. Enter the corporation's nonpassive credits without regard to the tax liability limitations _____
- P. Tax attributable to net active income. Subtract line O from line N _____
- Q. Tax attributable to net active income and net passive income. Add lines F and P. Enter the result here and on line 7 of Form 8810 _____

Line C.—Enter the net income, if any, from line 1d of Form 8810. If the corporation had an overall loss from the entire disposition of a passive activity, the amount to enter on line C is the net income from line 1d reduced by the overall loss, but not below zero. If the result is zero, skip the rest of the Part I computation.

Line E.—Compute the tax on this amount as if it were the corporation's only taxable income.

Line J.—If the corporation had net passive income, enter the amount from line C on this line. If the corporation has a net loss from line 1d of Form 8810, enter that amount on line J as a negative amount.

Line 9.—If the corporation had one type of credit, the amount on line 9 is the credit allowed for the year. See **Reporting Allowed Credits on Tax Return**, below.

Use Worksheet 6 on page 11 to figure how much of the credit on line 9 is allowed for each activity. Keep a record of the unallowed amount and the activity to which it belongs to compute the credit allowed in a subsequent year.

Instructions for 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 all 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 1991**. Keep a record of these amounts so the credits can be used in a subsequent year.

Column (d).—Subtract column (c) from column (a). These are the **allowed credits for 1991**. The amounts in this column should be reported on the forms normally used. See **Reporting Allowed Credits on Tax Return**, below.

Reporting Allowed Credits on Tax Return

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

Form 5735.—Enter any allowed possessions tax credit on line 14 of Form 5735. To the left of the entry write, "PAC."

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

Credit for fuel produced from a nonconventional source.—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 you are filing.

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 9 for the definition of a PTP.

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

1. Calculate 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 for use in a future year.

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.)
Totals ▶			1.00		