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From: [Redacted Text]

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To: [Redacted Text]

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Subject: Offsetting Passive Activity Losses

This is in response to your request for advice regarding a portion of the Tax Court's opinion in Anjum Shiekh v. Comm'r, T.C. Memo. 2010-126, concerning the offsetting of capital gains and ordinary losses on a disposition of property used in a passive activity. We generally agree with the Tax Court's overall analysis of the operation of the passive loss rules under § 469 in this case. However, we do not agree with one possible interpretation of the Court's conclusion on page 16 of the opinion stating that "[c]onsequently, the [ordinary] losses generated by the Ventura property should be deducted against the capital gain from the sale of the Ventura property." From this language, it appears to us that the Court's opinion could be read to require that such capital gain and ordinary losses offset each other for purposes of tax reporting and for calculating the amount of tax due from the taxpayer for the taxable year in question, outside of the scope and context of § 469(d)(1).

It is true that the gain from the disposition of property used in a passive activity is treated as passive income for purposes of applying the passive loss rules. See § 1.469-2T(c)(2) of the Income Tax Regulations. Passive activity loss is defined in § 469(d)(1) as the amount (if any) by which (A) the aggregated losses from all passive activities for the taxable year, exceed (B) the aggregate income from all passive activities for such year. Accordingly, for the limited purpose of calculating the disallowed "passive activity loss" of the taxpayer for the taxable year under § 469(d)(1) (for purposes of § 469(a)(1)(A)), the gain on the disposition of property used in a passive activity will be allowed to offset passive losses from the same or other passive activities of the taxpayer. The character of such gain or loss as capital or ordinary has no relevance for applying the rules of § 469, because the passive loss rules are only concerned with whether the relevant income and loss are from a passive activity. Instead, once it is determined that the passive losses of a taxpayer are no longer subject to disallowance under § 469(a)(1)(A) for a taxable year because the losses are either offset with a corresponding amount of passive income

under § 469(d)(1) or are recharacterized as "not from a passive activity" under § 469(g)(1)(A)), the tax rules that would otherwise apply to such gain or loss outside of § 469 will control the extent to which those gains and losses must offset each other for tax reporting purposes and for calculating the amount of tax due. Section 469 is merely a loss disallowance provision, and as such it does not change the character of any gain or loss once the loss is no longer subject to limitation under that provision. In this case, the rules under § 1211 et seq.. will determine whether the capital gain from the Ventura property must offset the ordinary losses produced by such property, and § 469 will play no role in this determination. Moreover, there is no provision in § 469 or the regulations thereunder requiring the offset of capital gain with ordinary losses for other tax purposes as apparently contemplated by the Tax Court in Anjum Sheikh v. Comm'r.

We hope this is helpful. If you have any additional questions or concerns regarding this advice, feel free to contact [Redacted Text] or [Redacted Text] at [Redacted Text]