

**Internal Revenue Code Section 469(e)(2)**

Passive activity losses and credits limited

(e) Special rules for determining income or loss from a passive activity. For purposes of this section—

(1) Certain income not treated as income from passive activity. In determining the income or loss from any activity—

(A) In general. There shall not be taken into account—

(i) any—

(I) gross income from interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business,

(II) expenses (other than interest) which are clearly and directly allocable to such gross income, and

(III) interest expense properly allocable to such gross income, and

(ii) gain or loss not derived in the ordinary course of a trade or business which is attributable to the disposition of property—

(I) producing income of a type described in clause (i), or

(II) held for investment.

For purposes of clause (ii), any interest in a passive activity shall not be treated as property held for investment.

(B) Return on working capital. For purposes of subparagraph (A), any income, gain, or loss which is attributable to an investment of working capital shall be treated as not derived in the ordinary course of a trade or business.



(2) Passive losses of certain closely held corporations may offset active income.

(A) In general. If a closely held C corporation (other than a personal service corporation) has net active income for any taxable year, the passive activity loss of such taxpayer for such taxable year (determined without regard to this paragraph)—

- (i) shall be allowable as a deduction against net active income, and
- (ii) shall not be taken into account under subsection (a) to the extent so allowable as a deduction. A similar rule shall apply in the case of any passive activity credit of the taxpayer.

(B) Net active income. For purposes of this paragraph, the term 'net active income' means the taxable income of the taxpayer for the taxable year determined without regard to—

- (i) any income or loss from a passive activity, and
- (ii) any item of gross income, expense, gain, or loss described in paragraph (1)(A).