

### Internal Revenue Code Section 469(c)(7)(A)(i)

#### Passive activity losses and credits limited

(c) Passive activity defined. For purposes of this section—

(1) In general. The term 'passive activity' means any activity—

(A) which involves the conduct of any trade or business, and

(B) in which the taxpayer does not materially participate.

(2) Passive activity includes any rental activity. Except as provided in paragraph (7), the term "passive activity" includes any rental activity.

(3) Working interests in oil and gas property.

(A) In general. The term 'passive activity' shall not include any working interest in any oil or gas property which the taxpayer holds directly or through an entity which does not limit the liability of the taxpayer with respect to such interest.

(B) Income in subsequent years. If any taxpayer has any loss for any taxable year from a working interest in any oil or gas property which is treated as a loss which is not from a passive activity, then any net income from such property (or any property the basis of which is determined in whole or in part by reference to the basis of such property) for any succeeding taxable year shall be treated as income of the taxpayer which is not from a passive activity. If the preceding sentence applies to the net income from any property for any taxable year, any credits allowable under subpart B (other than section 27(a)) or D of part IV of subchapter A for such taxable year which are attributable to such property shall be treated as credits not from a passive activity to the extent the amount of such credits does not exceed the regular tax liability of the taxpayer for the taxable year which is allocable to such net income.

(4) Material participation not required for paragraphs (2) and (3). Paragraphs (2) and (3) shall be applied without regard to whether or not the taxpayer materially participates in the activity.

(5) Trade or business includes research and experimentation activity. For purposes of paragraph (1)(A), the term 'trade or business' includes any activity involving research or experimentation (within the meaning of section 174).

(6) Activity in connection with trade or business or production of income. To the extent provided in regulations, for purposes of paragraph (1)(A), the term 'trade or business' includes—

(A) any activity in connection with a trade or business, or

(B) any activity with respect to which expenses are allowable as a deduction under section 212.

(7) Special rules for taxpayers in real property business.

(A) In general. If this paragraph applies to any taxpayer for a taxable year—



(i) paragraph (2) shall not apply to any rental real estate activity of such taxpayer for such taxable year, and

(ii) this section shall be applied as if each interest of the taxpayer in rental real estate were a separate activity.

Notwithstanding clause (ii), a taxpayer may elect to treat all interests in rental real estate as one activity. Nothing in the preceding provisions of this subparagraph shall be construed as affecting the determination of whether the taxpayer materially participates with respect to any interest in a limited partnership as a limited partner.

(B) Taxpayers to whom paragraph applies. This paragraph shall apply to a taxpayer for a taxable year if—

(i) more than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and

(ii) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. In the case of a joint return, the requirements of the preceding sentence are satisfied if and only if either spouse separately satisfies such requirements. For purposes of the preceding sentence, activities in which a spouse materially participates shall be determined under subsection (h).

(C) Real property trade or business. For purposes of this paragraph, the term "real property trade or business" means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

(D) Special rules for subparagraph (b).

- (i) Closely held C corporations. In the case of a closely held C corporation, the requirements of subparagraph (B) shall be treated as met for any taxable year if more than 50 percent of the gross receipts of such corporation for such taxable year are derived from real property trades or businesses in which the corporation materially participates.
  
- (ii) Personal services as an employee. For purposes of subparagraph (B), personal services performed as an employee shall not be treated as performed in real property trades or businesses. The preceding sentence shall not apply if such employee is a 5-percent owner (as defined in section 416(i)(1)(B)) in the employer.