

Publication 925

Passive Activity and At-Risk Rules

For use in preparing

2023 Returns

Volume 1 of 3



Get forms and other information faster and easier at:

- [IRS.gov](https://www.irs.gov) (English)
- [IRS.gov/Korean](https://www.irs.gov/Korean) (한국어)
- [IRS.gov/Spanish](https://www.irs.gov/Spanish) (Español)
- [IRS.gov/Russian](https://www.irs.gov/Russian) (Русский)
- [IRS.gov/Chinese](https://www.irs.gov/Chinese) (中文)
- [IRS.gov/Vietnamese](https://www.irs.gov/Vietnamese) (Tiếng Việt)



Publication 925 (Rev 2023) Catalog Number 39328F
Department of the Treasury **Internal Revenue Service** www.irs.gov

Visit the Accessibility
Page on [IRS.gov](https://www.irs.gov)

This page is intentionally left blank

Contents	Regular Page	Large Print Page
Future Developments	1	4
Introduction	2	9
Passive Activity Limits	3	13
Who Must Use These Rules?	3	13
Passive Activities	4	23
Activities That Aren't Passive Activities	7	42
Passive Activity Income and Deductions	9	57
Grouping Your Activities	12	78
Recharacterization of Passive Income	15	87
Dispositions	17	113

How To Report Your Passive Activity Loss	18	119
At-Risk Limits	19	121
Who Is Affected?	19	124
Activities Covered by the At-Risk Rules	20	128
At-Risk Amounts	21	139
Amounts Not at Risk	22	147
Reductions of Amounts at Risk	23	152
Recapture Rule	23	153
How To Get Tax Help	23	154
Index	27	178

Future Developments

For the latest developments related to Pub. 925, such as legislation enacted after it was published, go to [IRS.gov/Pub925](https://www.irs.gov/pub925).

Reminders

Excess business loss limitation. If you are a noncorporate taxpayer and have allowable business losses after taking into account first the at-risk limitations and then the passive loss limitations (Form 8582), your losses may be subject to the excess business loss limitation. After taking into account all the other loss limitations, complete Form 461, Limitation on Business Losses, to figure the amount of your excess business loss. See Form 461 and its instructions for details on the excess business loss limitation.

Commercial revitalization deduction (CRD). The 120-month deduction period for rental real estate placed in service by December 31, 2009, has expired. See Form 8582 and its instructions for reporting requirements for unused CRDs.

Changes in rules on grouping and definition of real property trade or business. T.D. 9943 revised certain rules in the Regulations under section 469.

- **Applicable date.** The new rules apply to tax years beginning on or after March 22, 2021, but you may chose to adopt these rules earlier. See Regulations section 1.469-11(a)(1) and (4) for additional information on applicability dates and early adoption. If you are a calendar year taxpayer, the new provision applies to you beginning in calendar year 2022.
- **Grouping rules.** T.D. 9943 added Regulations section 1.469-4(d)(6), which prohibits grouping of trading activities described in Temporary Regulations section 1.469-1T(e)(6) subject to section 163(d)(5)(A)(ii) involving a non-passive trade or business in which the taxpayer does not materially participate with any other activity or activities including other

trading activities. See Regulations section 1.469-4(d)(6) for more details.

- **Definition of real property trade or business.** T.D. 9905 and 9943 expanded Regulations section 1.469-9(b)(2)(i) to define several terms used in determining whether a trade or business is a real property trade or business for purposes of section 469(c)(7) (C). T.D. 9905 added Regulations sections 1.469-9(b) (2)(ii)(H) and (I) defining real property operations and real property management. T.D. 9943 added Regulations sections 1.469-9(b)(2)(ii)(A) and (B) defining real property development and real property redevelopment.

Regrouping due to Net Investment

Income Tax. You may be able to regroup your activities if you're subject to the Net Investment Income Tax. See *Regrouping Due to Net Investment Income Tax* under

Grouping Your Activities, later, for more information.

At-risk amounts. The following rules apply to amounts borrowed after May 3, 2004.

- You must file Form 6198, At-Risk Limitations, if you're engaged in an activity included in (6) under *Activities Covered by the At-Risk Rules* and you have borrowed certain amounts described in *Certain borrowed amounts excluded* under *At-Risk Amounts* in this publication.
- You may be considered at risk for certain amounts described in *Certain borrowed amounts excluded* under *At-Risk Amounts* secured by real property used in the activity of holding real property (other than mineral property) that, if nonrecourse, would be qualified nonrecourse financing.

Photographs of missing children. The Internal Revenue Service is a proud partner with the [National Center for Missing & Exploited Children® \(NCMEC\)](#). Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 800-THE-LOST (800-843-5678) if you recognize a child.

Introduction

This publication discusses two sets of rules that may limit the amount of your deductible loss from a trade, business, rental, or other income-producing activity. The first part of the publication discusses the passive activity rules. The second part discusses the at-risk rules. However, when you figure your allowable losses from any activity, you must apply the at-risk rules before the passive activity rules.

Comments and suggestions. We welcome your comments about this publication and suggestions for future editions.

You can send us comments through [IRS.gov/FormComments](https://www.irs.gov/FormComments). Or, you can write to the Internal Revenue Service, Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224.

Although we can't respond individually to each comment received, we do appreciate your feedback and will consider your comments and suggestions as we revise our tax forms, instructions, and publications.

Don't send tax questions, tax returns, or payments to the above address.

Getting answers to your tax questions. If you have a tax question not answered by this publication or the *How To Get Tax Help* section at the end of this publication, go to the IRS Interactive Tax Assistant page at [IRS.gov/ Help/ITA](https://www.irs.gov/Help/ITA) where you can find topics

by using the search feature or viewing the categories listed.

Getting tax forms, instructions, and publications. Go to [IRS.gov/Forms](https://www.irs.gov/forms) to download current and prior-year forms, instructions, and publications.

Ordering tax forms, instructions, and publications. Go to [IRS.gov/OrderForms](https://www.irs.gov/OrderForms) to order current forms, instructions, and publications; call 800-829-3676 to order prior-year forms and instructions. The IRS will process your order for forms and publications as soon as possible. **Don't** resubmit requests you've already sent us. You can get forms and publications faster online.

Useful Items

You may want to see:

Publication

- ☐ **527** Residential Rental Property
(Including Rental of Vacation Homes)

- ☐ **541** Partnerships

Form (and Instructions)

- ☐ **4952** Investment Interest Expense Deduction
- ☐ **6198** At-Risk Limitations
- ☐ **8582** Passive Activity Loss Limitations
- ☐ **8582-CR** Passive Activity Credit Limitations
- ☐ **8810** Corporate Passive Activity Loss and Credit Limitations
- ☐ **8949** Sales and Other Dispositions of Capital Assets

See *How To Get Tax Help* at the end of this publication for information about getting these publications and forms.

Passive Activity Limits

Who Must Use These Rules?

The passive activity rules apply to:

- Individuals,
- Estates,
- Trusts (other than grantor trusts),
- Personal service corporations, and
- Closely held corporations.

Even though the rules don't apply to grantor trusts, partnerships, and S corporations directly, they do apply to the owners of these entities.

For information about personal service corporations and closely held corporations, including definitions and how the passive activity rules apply to these corporations, see Form 8810 and its instructions.



Before applying the passive activity limits, you must first determine the amount of the deductions disallowed under the basis or at-risk rules. See Passive Activity Deductions, later.

Passive Activity Loss

Generally, the passive activity loss for the tax year isn't allowed. However, there is a special allowance under which some or all of your passive activity loss may be allowed. See Special \$25,000 allowance, later.

Definition of passive activity loss.

Generally, your passive activity loss for the tax year is the excess of your passive activity deductions over your passive activity gross income. See Passive Activity Income and Deductions, later.

For a closely held corporation, the passive activity loss is the excess of passive activity deductions over the sum of passive activity gross income and net active income. For

details on net active income, see the Instructions for Form 8810. For the definition of passive activity gross income, see Passive Activity Income, later. For the definition of passive activity deductions, see Passive Activity Deductions, later.

Identification of Disallowed Passive Activity Deductions

If all or a part of your passive activity loss is disallowed for the tax year, you may need to allocate the disallowed passive activity loss among different passive activities and among different deductions within a passive activity.

Allocation of disallowed passive activity loss among activities. If all or any part of your passive activity loss is disallowed for the tax year, a ratable portion of the loss (if any) from each of your passive activities is disallowed. The ratable portion of a loss from an activity is computed by multiplying the passive activity loss that's disallowed for the tax year by the fraction obtained by dividing:

1. The loss from the activity for the tax year; by
2. The sum of the losses for the tax year from all activities having losses for the tax year.

Use Part VII of Form 8582 to figure the ratable portion of the loss from each activity that's disallowed.

Loss from an activity. The term "loss from an activity" means:

1. The amount by which the passive activity deductions (defined later) from the activity for the tax year exceed the passive activity gross income (defined later) from the activity for the tax year; reduced by
2. Any part of such amount that's allowed under the *Special \$25,000 allowance*, later.

If your passive activity gross income from significant participation passive activities (defined later) for the tax year is more than your passive activity deductions from those activities for the tax year, those activities shall be treated, solely for purposes of figuring your loss from the activity, as a single activity that doesn't have a loss for such tax year. See Significant Participation Passive Activities, later.

Example. Terry holds interests in three passive activities, A, B, and C. The gross income and deductions from these activities for the tax year are as follows.

	A	B	C	Total
Gross income	\$7,000	\$4,000	\$12,000	\$23,000
Deductions	16,000	20,000	8,000	44,000
Net income (loss)	<u>\$9,000</u>	<u>\$16,000</u>	<u>\$4,000</u>	<u>\$21,000</u>

Terry's \$21,000 passive activity loss for the tax year is disallowed. Therefore, a ratable portion of the losses from activities A and B is disallowed. The disallowed portion of each loss is as follows.

A: \$21,000 x \$9,000/ \$25,000	\$7,560
B: \$21,000 x \$16,000/ \$25,000	13,440
	<hr/>
Total	<u>\$21,000</u>

Allocation within loss activities. If all or any part of your loss from an activity is disallowed under Allocation of disallowed passive activity loss among activities for the tax year, a ratable portion of each of your passive activity deductions (defined later), other than an excluded deduction (defined next) from such activity is disallowed. The ratable portion of a passive activity deduction

is the amount of the disallowed portion of the loss from the activity for the tax year multiplied by the fraction obtained by dividing:

1. The amount of such deduction; by
2. The sum of all of your passive activity deductions (other than excluded deductions) from that activity from the tax year.

Excluded deductions. “Excluded deduction” means any passive activity deduction that’s taken into account in computing your net income from an item of property for a tax year in which an amount of the taxpayer's gross income from such item of property is treated as not from a passive activity. See *Recharacterization of Passive Income*, later.

Separately identified deductions. In identifying the deductions from an activity that are disallowed, you don’t need to account separately for a deduction unless such

deduction may, if separately taken into account, result in an income tax liability for any tax year different from that which would result were such deduction not taken into account separately.

Use Form 8582, Part IX, for any activity if you have passive activity deductions for that activity that must be separately identified.

Deductions that must be accounted for separately include (but aren't limited to) the following deductions.

- Deductions that arise in a rental real estate activity in tax years in which you actively participate in such activity. See Active participation, later.
- Deductions that arise in a rental real estate activity in tax years in which you don't actively participate in such activity. See Active participation, later.
- Losses from sales or exchanges of capital assets.

- Section 1231 losses. See *Section 1231 Gains and Losses* in Pub. 544, *Sales and Other Dispositions of Assets*, for more information.

Carryover of Disallowed Deductions

In the case of an activity with respect to which any deductions or credits are disallowed for a tax year (the loss activity), the disallowed deductions are allocated among your activities for the next tax year in a manner that reasonably reflects the extent to which each activity continues the loss activity. The disallowed deductions or credits allocated to an activity under the preceding sentence are treated as deductions or credits from the activity for the next tax year. For more information, see Regulations section 1.469-1(f)(4).

Passive Activity Credit

Generally, the passive activity credit for the tax year is disallowed.

The passive activity credit is the amount by which the sum of all your credits subject to the passive activity rules exceed your regular tax liability allocable to all passive activities for the tax year. Credits that are included in figuring the general business credit are subject to the passive activity rules.

See the Instructions for Form 8582-CR for more information.

Publicly Traded Partnership

You must apply the rules in this part separately to your income or loss from a passive activity held through a publicly traded partnership (PTP). You must also apply the limit on passive activity credits separately to your credits from a passive activity held through a PTP.

You can offset deductions from passive activities of a PTP only against income or gain from passive activities of the same PTP. Likewise, you can offset credits from passive

activities of a PTP only against the tax on the net passive income from the same PTP. This separate treatment rule also applies to a regulated investment company holding an interest in a PTP for the items attributable to that interest.

For more information on how to apply the passive activity loss rules to PTPs, and on how to apply the limit on passive activity credits to PTPs, see *Publicly Traded Partnerships (PTPs)* in the instructions for Forms 8582 and 8582-CR, respectively.

Passive Activities

There are two kinds of passive activities.

- Trade or business activities in which you don't materially participate during the year.
- Rental activities, even if you do materially participate in them, unless you're a real estate professional.

Material participation in a trade or business is discussed, later, under Activities That Aren't Passive Activities.

Treatment of former passive activities.

A former passive activity is an activity that was a passive activity in any earlier tax year, but isn't a passive activity in the current tax year. You can deduct a prior-year unallowed loss from the activity up to the amount of your current-year net income from the activity. Treat any remaining prior-year unallowed loss like you treat any other passive loss.

In addition, any prior-year unallowed passive activity credits from a former passive activity offset the allocable part of your current-year tax liability. The allocable part of your current-year tax liability is that part of this year's tax liability that's allocable to the current-year net income from the former passive activity. You figure this after you reduce your net income from the activity by

any prior-year unallowed loss from that activity (but not below zero).

Trade or Business Activities

A trade or business activity is an activity that:

- Involves the conduct of a trade or business (that is, deductions would be allowable under section 162 of the Internal Revenue Code if other limitations, such as the passive activity rules, didn't apply);
- Is conducted in anticipation of starting a trade or business; or
- Involves research or experimental expenditures that are deductible under Internal Revenue Code section 174 (or that would be deductible if you chose to deduct rather than capitalize them).

A trade or business activity doesn't include a rental activity or the rental of property that's

incidental to an activity of holding the property for investment.

You generally report trade or business activities on Schedule C, F, or in Part II or III of Schedule E.

Rental Activities

A rental activity is a passive activity even if you materially participated in that activity, unless you materially participated as a real estate professional. See *Real Estate Professional* under *Activities That Aren't Passive Activities*, later. 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. It doesn't matter whether the use is under a lease, a service contract, or some other arrangement.

Exceptions. Your activity isn't a rental activity if any of the following apply.

1. The average period of customer use of the property is 7 days or less. You figure the average period of customer use 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 a fraction. The numerator of the fraction is the gross rental income from that class of property and the denominator is the activity's total gross rental income. The activity's average period of customer use will equal the sum of the amounts for each class.
2. The average period of customer use of the property, as figured in (1) above, is 30 days or less and you provide

significant personal services with the rentals. Significant personal services include only services performed by individuals. To determine if personal services are significant, all relevant facts and circumstances are taken into consideration, including 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 use of the property. Significant personal services don't include the following.

- a. Services needed to permit the lawful use of the property;
- b. Services to repair or improve property that would extend its useful life for a period substantially longer than the average rental; and
- c. Services that are similar to those commonly provided with long-

term rentals of real estate, such as cleaning and maintenance of common areas or routine repairs.

3. You provide extraordinary personal services in making the rental property available for customer use. Services are extraordinary personal services if they're performed by individuals and the customers' use of the property is incidental to their receipt of the services.
4. The rental 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 its appreciation and the gross rental income from the property is less than 2% of the smaller of the property's unadjusted basis or fair market value. The unadjusted basis of property is its cost not

reduced by depreciation or any other basis adjustment. The rental of property is incidental to a trade or business activity if all of the following apply.

- a. You own an interest in the trade or business activity during the year.
- b. The rental property was used mainly in that trade or business activity during the current year, or during at least 2 of the 5 preceding tax years.
- c. Your gross rental income from the property is less than 2% of the smaller of its unadjusted basis or fair market value.
Lodging provided to an employee or the employee's spouse or dependents is incidental to the activity or activities in which the employee performs services if the

lodging is furnished for the employer's convenience.

5. You customarily make the rental property available during defined business hours for nonexclusive use by various customers.
6. You provide the property for use in a nonrental activity in your capacity as an owner of an interest in the partnership, S corporation, or joint venture conducting that activity.



If you meet any of the exceptions listed above, see the Instructions for Form 8582 for information about how to report any income or loss from the activity.

Special \$25,000 allowance. If you or your spouse actively participated in a passive rental real estate activity, the amount of the passive activity loss that's disallowed is decreased and you therefore can deduct up to \$25,000 of loss from the activity from your

nonpassive income. This special allowance is an exception to the general rule disallowing the passive activity loss. Similarly, you can offset credits from the activity against the tax on up to \$25,000 of nonpassive income after taking into account any losses allowed under this exception.

If you're married, filing a separate return, and lived apart from your spouse for the entire tax year, your special allowance can't be more than \$12,500. If you lived with your spouse at any time during the year and are filing a separate return, you can't use the special allowance to reduce your nonpassive income or tax on nonpassive income.

The maximum special allowance is reduced if your modified adjusted gross income exceeds certain amounts. See *Phaseout rule*, later.

Example. You are a single taxpayer. You have \$70,000 in wages, \$15,000 income from a limited partnership, a \$26,000 loss from rental real estate activities in which you

actively participated. Because your modified adjusted gross income is less than \$100,000, you aren't subject to the modified adjusted gross income phaseout rule. You can use \$15,000 of your \$26,000 loss to offset your \$15,000 passive income from the partnership. You actively participated in your rental real estate activities, so you can use the remaining \$11,000 rental real estate loss to offset \$11,000 of your nonpassive income (wages).

Active participation. Active participation isn't the same as material participation (defined later). Active participation is a less stringent standard than material participation. For example, you may be treated as actively participating if you make management decisions in a significant and bona fide sense. Management decisions that count as active participation include approving new tenants, deciding on rental terms, approving expenditures, and similar decisions.

Only individuals can actively participate in rental real estate activities. However, a decedent's estate is treated as actively participating for its tax years ending less than 2 years after the decedent's death, if the decedent would have satisfied the active participation requirement for the activity for the tax year the decedent died.

A decedent's qualified revocable trust can also be treated as actively participating if both the trustee and the executor (if any) of the estate choose to treat the trust as part of the estate. The choice applies to tax years ending after the decedent's death and before:

- 2 years after the decedent's death if no estate tax return is required, or
- 6 months after the estate tax liability is finally determined if an estate tax return is required.

The choice is irrevocable and can't be made later than the due date for the estate's first income tax return (including any extensions).

Except as provided in regulations, limited partners aren't treated as actively participating in a partnership's rental real estate activities.

You aren't treated as actively participating in a rental real estate activity unless your interest in the activity (including your spouse's interest) was at least 10% (by value) of all interests in the activity throughout the year.

Active participation isn't required to take the low-income housing credit or the rehabilitation investment credit from rental real estate activities.

Example. Stacey, a single taxpayer, had the following income and loss during the tax year.

Salary	\$42,300
Dividends.....	300
Interest.....	1,400
Rental loss.....	(4,000)

The rental loss came from a house Stacey owned. Stacey advertised and rented the house to the current tenant. Stacey also collected the rents and did the repairs or hired someone to do them.

Even though the rental loss is a loss from a passive activity, Stacey can use the entire \$4,000 loss to offset other income because Stacey actively participated.

Phaseout rule. The maximum special allowance of \$25,000 (\$12,500 for married individuals filing separate returns and living

apart at all times during the year) is reduced by 50% of the amount of your modified adjusted gross income that's more than \$100,000 (\$50,000 if you're married filing separately). If your modified adjusted gross income is \$150,000 or more (\$75,000 or more if you're married filing separately), you generally can't use the special allowance. This is because the special allowance is reduced to \$0 since the modified adjusted gross income is over the \$100,000 amount.

Modified adjusted gross income for this purpose is your adjusted gross income figured without the following.

- Taxable social security and Tier 1 railroad retirement benefits.
- Deductible contributions to individual retirement accounts (IRAs) and section 501(c)(18) pension plans.

- The exclusion from income of interest from qualified U.S. savings bonds used to pay qualified higher education expenses.
- The exclusion from income of amounts received from an employer's adoption assistance program.
- Passive activity income or loss included on Form 8582.
- Any rental real estate loss allowed because you materially participated in the rental activity as a Real Estate Professional (as discussed, later, under *Activities That Aren't Passive Activities*).
- Any overall loss from a publicly traded partnership (see *Publicly Traded Partnerships (PTPs)* in the instructions for Form 8582).
- The deduction allowed for the deductible part of self-employment tax.

- Foreign-derived intangible income and global intangible low-taxed income.
- The deduction allowed for interest on student loans.

Example. During 2023, you were unmarried and weren't a real estate professional. For 2023, you had \$120,000 in salary and a \$31,000 loss from your rental real estate activities in which you actively participated. Your modified adjusted gross income is \$120,000. When you file your 2023 return, you can deduct only \$15,000 of your passive activity loss. You must carry over the remaining \$16,000 passive activity loss to 2024. You figure your deduction and carryover as follows.

Adjusted gross income, modified as required	\$120,000
Minus amount not subject to phaseout	<u>-100,000</u>

Amount subject to phaseout rule	\$20,000
Multiply by 50% (0.50).....	<u>× 50%</u>
Required reduction to special allowance.....	<u>\$10,000</u>
Maximum special allowance.....	\$25,000
Minus required reduction (see above)	<u>-10,000</u>
Adjusted special allowance.....	<u>\$15,000</u>
Passive loss from rental real estate	\$31,000
Deduction allowable/Adjusted special allowance (see above).	<u>-15,000</u>
Amount that must be carried forward	<u>\$16,000</u>

Exceptions to the phaseout rules. A higher phaseout range applies to rehabilitation investment credits from rental real estate activities. For those credits, the phaseout of the \$25,000 special allowance starts when your modified adjusted gross income exceeds \$200,000 (\$100,000 if you're a married individual filing a separate return and living apart at all times during the year).

There is no phaseout of the \$25,000 special allowance for low-income housing credits.

Ordering rules. If you have more than one of the exceptions to the phaseout rules in the same tax year, you must apply the \$25,000 phaseout against your passive activity losses and credits in the following order.

1. Passive activity losses.
2. The portion of passive activity credits attributable to credits other than the rehabilitation and low-income housing credits.

3. The portion of passive activity credits attributable to the rehabilitation credit.
4. The portion of passive activity credits attributable to the low-income housing credit.

Activities That Aren't Passive Activities

The following aren't passive activities.

1. Trade or business activities in which you materially participated for the tax year.
2. A working interest in an oil or gas well that you hold directly or through an entity that doesn't limit your liability (such as a general partner interest in a partnership). It doesn't matter whether you materially participated in the activity for the tax year. However, if your liability was limited for part of the year (for example, you converted

your general partner interest to a limited partner interest during the year) and you had a net loss from the well for the year, some of your income and deductions 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. The rental of a dwelling unit that you also used for personal purposes during the year for more than the greater of 14 days or 10% of the number of days during the year that the home was rented at a fair rental.
4. An activity of trading personal property for the account of those who own interests in the activity. See Temporary Regulations section 1.469-1T(e)(6).
5. Rental real estate activities in which you materially participated as a real

estate professional. See Real Estate Professional, later.



You shouldn't enter income and losses from these activities on Form 8582, as they are not passive activities.

Instead, enter them on the forms or schedules you would normally use.

Material Participation

A trade or business activity isn't a passive activity if you materially participated in the activity.

Material participation tests. You materially participated in a trade or business activity for a tax year if you satisfy any of the following tests.

1. You participated in the activity for more than 500 hours.
2. Your participation was substantially all the participation in the activity of all individuals for the tax year, including

the participation of individuals who didn't own any interest in the activity.

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 didn't own any interest in the activity) for the year.
4. The activity is a significant participation activity, and you participated in all significant participation activities 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 didn't materially participate under any of the material participation tests, other than this test. See Significant Participation Passive Activities under

Recharacterization of Passive Income,
later.

5. You materially participated in the activity (other than by meeting this fifth test) for any 5 (whether or not consecutive) of the 10 immediately preceding tax years.
6. The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years. An activity is a personal service activity if it involves the performance of personal services in the fields of health (including veterinary services), law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital isn't 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 year.

You didn't materially participate in the activity under test (7) if you participated in the activity for 100 hours or less during the year. Your participation in managing the activity doesn't count in determining whether you materially participated under this test if:

- Any person other than you received compensation for managing the activity, or
- Any individual spent more hours during the tax year managing the activity than you did (regardless of whether the individual was compensated for the management services).

Participation. In general, any work you do in connection with an activity in which you own an interest is treated as participation in the activity.

Work not usually performed by owners.

You don't treat the work you do in connection with an activity as participation in the activity if both of the following are true.

- The work isn't work that's customarily done by the owner of that type of activity.
- One of your main reasons for doing the work is to avoid the disallowance of any loss or credit from the activity under the passive activity rules.

Participation as an investor. You don't treat the work you do in your capacity as an investor in an activity as participation unless you're directly involved in the day-to-day management or operations of the activity. Work you do as an investor includes:

- Studying and reviewing financial statements or reports on operations of the activity,

- Preparing or compiling summaries or analyses of the finances or operations of the activity for your own use, and
- Monitoring the finances or operations of the activity in a nonmanagerial capacity.

Spouse's participation. Your participation in an activity includes your spouse's participation. This applies even if your spouse didn't own any interest in the activity and you and your spouse don't file a joint return for the year.



Proof of participation. You can use any reasonable method to prove your participation in an activity for the year. You don't have to keep contemporaneous daily time reports, logs, or similar documents if you can establish your participation in some other way. For example, you can show the services you performed and the approximate number of hours spent by using an appointment book, calendar, or narrative summary.

Limited partners. If you owned an activity as a limited partner, you generally aren't treated as materially participating in the activity. However, you're treated as materially participating in the activity if you met test (1), (5), or (6) under Material participation tests, discussed earlier, for the tax year.

You aren't treated as a limited partner, however, if you were also 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 that part of the partnership's tax year in which you directly or indirectly owned your limited partner interest).

Retired or disabled farmer and surviving spouse of a farmer. If you're a retired or disabled farmer, you're treated as materially participating in a farming activity if you materially participated for 5 or more of the 8 years before your retirement or disability. Similarly, if you're a surviving spouse of a

farmer, you're treated as materially participating in a farming activity if the real property used in the activity meets the estate tax rules for special valuation of farm property passed from a qualifying decedent, and you actively manage the farm.

Corporations. A closely held corporation or a personal service corporation is treated as materially participating in an activity only if one or more shareholders holding more than 50% by value of the outstanding stock of the corporation materially participate in the activity.

A closely held corporation can also satisfy the material participation standard by meeting the first two requirements for the qualifying business exception from the at-risk limits.

See *Special exception for qualified corporations* under *Activities Covered by the At-Risk Rules*, later.

Real Estate Professional

Generally, rental activities are passive activities even if you materially participated in them. However, if you qualified as a real estate professional, rental real estate activities in which you materially participated aren't passive activities. For this purpose, each interest you have in a rental real estate activity is a separate activity, unless you choose to treat all interests in rental real estate activities as one activity. See the Instructions for Schedule E (Form 1040), Supplemental Income and Loss, for information about making this choice.

If you qualified as a real estate professional for 2023, report income or losses from rental real estate activities in which you materially participated as nonpassive income or losses, and complete line 43 of Schedule E (Form 1040). If you also have an unallowed loss from these activities from an earlier year when you didn't qualify, see *Treatment of*

former passive activities under *Passive Activities*, earlier.

Qualifications. You qualified as a real estate professional for the year if you met both of the following requirements.

- More than half of the personal services you performed in all trades or businesses during the tax year were performed in real property trades or businesses in which you materially participated.
- You performed more than 750 hours of services during the tax year in real property trades or businesses in which you materially participated.

Don't count personal services you performed as an employee in real property trades or businesses unless you were a 5% owner of your employer. You were a 5% owner if you owned (or are considered to have owned) more than 5% of your employer's outstanding

stock, outstanding voting stock, or capital or profits interest.

If you file a joint return, don't count your spouse's personal services to determine whether you met the preceding requirements. However, you can count your spouse's participation in an activity in determining if you materially participated.

Real property trades or businesses. A real property trade or business is a trade or business that does any of the following with real property.

- Develops or redevelops it.
- Constructs or reconstructs it.
- Acquires it.
- Converts it.
- Rents or leases it.
- Operates or manages it.
- Brokers it.

Real property development. Real property development is a trade or business that includes the maintenance and improvement of raw land to make it suitable for subdivision, further development, or construction of residential or commercial buildings. Also included in real property development is the establishment, cultivation, maintenance, or improvement of timberlands.

Real property redevelopment. Real property redevelopment is a trade or business that includes demolition, deconstruction, separation, and removal of existing buildings, landscaping, and infrastructure on a parcel of land to return the land to a raw condition or otherwise prepare the land for new development or construction, or for establishment, cultivation, maintenance, or improvement of timberlands.

Real property operations. Real property operations involve handling the day-to-day operations of a trade or business relating to

the maintenance and occupancy of the real property affecting its availability or functionality by a direct or indirect owner. The real property must be used, or held for use, by customers and payments received must be principally for the customer's use of the property and not for the provision of other significant or extraordinary personal services.

Real property management. Real property management involves handling the day-to-day operations of a trade or business relating to the maintenance and occupancy of the real property affecting its availability or functionality by a professional manager. The real property must be used, or held for use, by customers and payments received must be principally for the customer's use of the property and not for the provision of other significant or extraordinary personal services. A professional manager is a person who is not a direct or indirect owner of the real property or properties and who is responsible for, on a

full-time basis, management and oversight of the real property or properties.

Closely held corporations. A closely held corporation can qualify as a real estate professional if more than 50% of the gross receipts for its tax year came from real property trades or businesses in which it materially participated.

Passive Activity Income and Deductions

In figuring your net income or loss from a passive activity, take into account only passive activity income and passive activity deductions.

Self-charged interest. Certain self-charged interest income or deductions may be treated as passive activity gross income or passive activity deductions if the loan proceeds are used in a passive activity.

Generally, self-charged interest income and deductions result from loans between you and a partnership or S corporation in which you had a direct or indirect ownership interest. This includes both loans you made to the partnership or S corporation and loans the partnership or S corporation made to you.

It also includes loans from one partnership or S corporation to another partnership or S corporation if each owner in the borrowing entity has the same proportional ownership interest in the lending entity.

Exception. The self-charged interest rules don't apply to your interest in a partnership or S corporation if the entity made an election under Regulations section 1.469-7(g) to avoid the application of these rules. For more details on the self-charged interest rules, see Regulations section 1.469-7.

Passive Activity Income

Passive activity income includes all income from passive activities and generally includes gain from disposition of an interest in a passive activity or property used in a passive activity.

Passive activity income doesn't include the following items.

- Income from an activity that isn't a passive activity. These activities are discussed under Activities That Aren't Passive Activities, earlier.
- Portfolio income. This includes interest, dividends, annuities, and royalties not derived in the ordinary course of a trade or business. It includes gain or loss from the disposition of property that produces these types of income or that's held for investment. The exclusion for portfolio income doesn't apply to self-charged interest treated as passive activity

income. For more information on self-charged interest, see *Self-charged interest*, earlier.

- Personal service income. This includes salaries, wages, commissions, self-employment income from trade or business activities in which you materially participated, deferred compensation, taxable social security and other retirement benefits, and payments from partnerships to partners for personal services.
- Income from positive section 481 adjustments allocated to activities other than passive activities. (Section 481 adjustments are adjustments that must be made due to changes in your accounting method.)
- 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, as discussed in item (2) under Activities That Aren't Passive Activities, earlier. This also applies to income from other oil and gas property, the basis of which is determined wholly or partly by the basis of the property in the preceding sentence.
- Any income from intangible property, such as a patent, copyright, or literary, musical, or artistic composition, if your personal efforts significantly contributed to the creation of the property.
- Any other income that must be treated as nonpassive income. See Recharacterization of Passive Income, later.
- Overall gain from any interest in a publicly traded partnership. See *Publicly Traded*

Partnerships (PTPs) in the instructions for Form 8582.

- State, local, and foreign income tax refunds.
- Income from a covenant not to compete.
- Reimbursement of a casualty or theft loss included in gross income to recover all or part of a prior-year loss deduction, if the loss deduction wasn't a passive activity deduction.
- Alaska Permanent Fund dividends.
- Cancellation of debt income, if at the time the debt is discharged the debt isn't allocated to passive activities under the interest expense allocation rules. See Temporary Regulations section 1.163-8T for information about the rules for allocating interest.