Definitions
Except as otherwise indicated, the following terms are defined as shown below.

Personal service corporation. A personal service corporation is a corporation whose principal activity is personal services. The principal activity of a corporation is considered to be the performance of personal services if, during the testing period, the corporation’s compensation costs for personal services are more than 50% of its total compensation costs.

Performance of personal services. Personal services are those performed in the health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting fields (as defined in Temporary Regulations section 1.448-1T(e)). The term “performance of personal services” includes any activity involving the performance of personal services in these areas.

Substantial performance by employee-owners. Personal services are substantially performed by employee-owners if, for the testing period, more than 20% of the corporation’s compensation costs for the performance of personal services are for services performed by employee-owners.

Employee-owner. A person is considered to be an employee-owner if the person is an employee of the corporation on any day of the testing period, and owns any outstanding stock of the corporation on any day of the testing period. Stock ownership is determined under the stock attribution rules of section 318, except that “any” is substituted for “50 percent or more in value” in section 318(a)(2)(C).

For more information about personal service corporations, see Regulations section 1.441-3(c).

Closely held corporation. A corporation is a closely held corporation if at any time during the last half of the tax year more than 50% in value of its outstanding stock is directly or indirectly owned, by or for not more than five individuals, and the corporation is not a personal service corporation.

Coordinating With Other Limitations
Generally, items of deduction or loss from a passive activity are subject to other limitations (for example, basis, section 163(j) interest deduction limitations, and at-risk limitations) before they are subject to the passive activity limitations. Personal service corporations and closely held corporations use Form 8810 to figure the personal services deduction or loss for each activity. This includes any current year gains or losses from the disposition of assets or an interest in the activity.

Overall gain. The excess of the “net income” from the activity over the prior year unallowed losses from the activity.

Overall loss. 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. The deductions and losses from an activity that were disallowed under the PAL limitations in a prior year and carried forward to the tax year under section 469(b). See Regulations section 1.469-1(f)(4).

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.
• Gain or loss on dispositions.
• Net active income (for a consolidated group treated as a closely held corporation).
• Credits from passive activities.
Activities That Are Not Passive Activities

The following are not classified as passive activities. Generally, income, losses, and credits from these activities are not entered on Form 8810. However, losses and credits from these activities may be subject to limitations other than the passive activity loss and credit rules.

1. Trade or business activities in which the corporation materially participated for the tax year.
2. Any rental real estate activity in which the corporation materially participated if the corporation was a closely held corporation that derived more than 50% of its gross receipts from real property trades or businesses in which it materially participated.

For purposes of this rule, each interest in rental real estate is a separate activity, unless the corporation elects to treat all interests in rental real estate as one activity. The corporation makes the election by attaching a statement to its original income tax return for the tax year. See Regulations section 1.469-9(g) for details on how to make or revoke this election. Also, see Rev. Proc. 2011-34, 2011-24 I.R.B. 874, available at www.irs.gov/irb/2011-24_IRB/ar07.html.

A real property trade or business is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

Note. If an activity qualifies for the exception described above in 2011, but has a prior year PAL, the prior year unallowed loss is treated as a loss from a former passive activity. See Former Passive Activities, later.

3. A working interest in an oil or gas well that is not materially participatory, and that is not engaged in a rental business. The corporation is treated as if it were the owner of the working interest. See Regulations section 1.469-9(g) for details on how to make or revoke this election. Also, see Rev. Proc. 2011-34, 2011-24 I.R.B. 874, available at www.irs.gov/irb/2011-24_IRB/ar07.html.

An activity is a rental activity if tangible property 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 does not matter whether the use of the property is under a lease, a service contract, or some other arrangement.

Exceptions

An activity is not a rental activity if:

1. The average period of customer use (see below) of the rental property is:
   a. 7 days or less, or
   b. 30 days or less and significant personal services are provided in making the rental property available for customer use.

2. Extraordinary personal services are later provided in making the rental property available for customer use.

Note. Significant personal services are services performed by individuals. To determine if personal services are significant, all the 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 the use of the property.

4. The rental of property is incidental to a nonrental activity.

The corporation is treated as if it were the owner of the property used in the nonrental activity of a partnership or joint venture. The corporation is treated as if it were the owner of the property used in the nonrental activity of a partnership or joint venture if the corporation materially participated in the activity. The activity is not treated as a real property trade or business activity. See Former Passive Activities, later.

The corporation is treated as if it were the owner of the property used in a nonrental activity of a partnership or joint venture if:

1. The average period of customer use is:
   a. 7 days or less, or
   b. 30 days or less and significant personal services are provided in making the rental property available for customer use.

2. Extraordinary personal services are later provided in making the rental property available for customer use.

Note. If an activity qualifies for the exceptions described above in 2011, but has a prior year PAL, the prior year unallowed loss is treated as a loss from a former passive activity. See Former Passive Activities, later.

4. 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 the partnership or joint venture.

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.

Also, 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 capacity of an owner of an interest in the partnership is made on the basis of all the facts and circumstances.

Rental Activities

A rental activity is a passive activity even if the corporation materially participated in the activity unless it meets the requirements described in item 2 in Activities That Are Not Passive Activities above. In addition, if the corporation meets any of the five exceptions listed below, the property is not treated as a rental activity. See Reporting Income, Deductions, Losses, and Credits From Rental Activities below, if the corporation meets any of the exceptions.

An activity is a rental activity if tangible property 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 does not matter whether the use of the property is under a lease, a service contract, or some other arrangement.

Exceptions

An activity is not a rental activity if:

1. The average period of customer use (see below) of the rental property is:
   a. 7 days or less, or
   b. 30 days or less and significant personal services are provided in making the rental property available for customer use.

2. Extraordinary personal services are later provided in making the rental property available for customer use.

Note. Significant personal services are services performed by individuals. To determine if personal services are significant, all the 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 the use of the property.

4. The rental of property is incidental to a nonrental activity.

The corporation is treated as if it were the owner of the property used in the nonrental activity of a partnership or joint venture. The corporation is treated as if it were the owner of the property used in the nonrental activity of a partnership or joint venture if the corporation materially participated in the activity. The activity is not treated as a real property trade or business activity. See Former Passive Activities, later.

The corporation is treated as if it were the owner of the property used in a nonrental activity of a partnership or joint venture if:

1. The average period of customer use is:
   a. 7 days or less, or
   b. 30 days or less and significant personal services are provided in making the rental property available for customer use.

2. Extraordinary personal services are later provided in making the rental property available for customer use.

Extraordinary personal services are services provided in making rental property available for customer use only if they are performed by individuals and the customers’ use of the property is incidental to their receipt of the service.

3. The rental activity is incidental to a nonpassive activity.

The rental of property is incidental to a nonpassive activity if:

1. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

2. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

3. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

4. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

5. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

6. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

7. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

8. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

9. The rental of property is incidental to a nonpassive activity if:
   a. The activity is engaged in a rental activity only if they are performed by individuals.

10. The rental of property is incidental to a nonpassive activity if:
    a. The activity is engaged in a rental activity only if they are performed by individuals.

11. The rental of property is incidental to a nonpassive activity if:
    a. The activity is engaged in a rental activity only if they are performed by individuals.

12. The rental of property is incidental to a nonpassive activity if:
    a. The activity is engaged in a rental activity only if they are performed by individuals.

13. The rental of property is incidental to a nonpassive activity if:
    a. The activity is engaged in a rental activity only if they are performed by individuals.

14. The rental of property is incidental to a nonpassive activity if:
    a. The activity is engaged in a rental activity only if they are performed by individuals.

15. The rental of property is incidental to a nonpassive activity if:
    a. The activity is engaged in a rental activity only if they are performed by individuals.

16. The rental of property is incidental to a nonpassive activity if:
    a. The activity is engaged in a rental activity only if they are performed by individuals.

17. The rental of property is incidental to a nonpassive activity if:
    a. The activity is engaged in a rental activity only if they are performed by individuals.
treated as incidental to an activity of holding property for investment) that:

1. Involves the conduct of a trade or business (within the meaning of section 162).
2. Is conducted in anticipation of starting a trade or business, or
3. Involves research or experimental expenditures deductible under section 174 (or that would be if the corporation chose to deduct rather than capitalize them).

**Reporting 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, that 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 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)*, later, for details about how to report income or losses from significant participation passive activities.

In general, if the corporation has credits from passive activities, use Worksheet 5 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*, later, for details about how to report credits from these activities.

**Material Participation**

Personal service corporations and closely held corporations materially or significantly participate in an activity 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% (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 qualifying business requirements of section 465(c)(7)(C) (without regard to section 465(c)(7)(C)(iv) for the excluded 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 the services of at least one full-time other than those in the active management of the activity; and
2. During the same period, substantially all the services of at least three full-time 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 in section 469(c), the participation 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 activity loss and credit rules.

**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 during the tax year by that and the approximate number of hours spent performing the services during that period, based on appointment books, calendars, or narrative summaries.

**Tests for investors.** Work done as an investor in an activity is not treated as participation under the passive activity loss and credit rules. 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, or consulting in any other trade or business in which capital is not a material income-producing factor.

7. Based on all 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 tax 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).

**Special rules for limited partners.** Generally, a limited partner cannot materially participate in an activity. However, the corporation is considered materially to participate in an activity in which it holds a limited partnership interest if one or more individuals (each of whom would materially participate in the activity under test 1, 5, or 6) were the beneficial owners of more than 50% (by value) of the partnership interest if one or more individuals (including the limited partner) who own more than 50% (by value) of the limited partnership interest were the beneficial owners of more than 50% (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 tax year of the corporation’s activity and the individual participated in the partnership activity directly or indirectly owned a limited partnership interest.

A limited partner’s share of an electing large partnership’s taxable income or loss and credits (including general business credits) from all trade or business activities or rental activities is treated as income or loss from the conduct of a single passive trade or business activity.

**Consolidated groups.** See Regulations section 1.469-1(h)(4) for rules for determining whether a consolidated group materially or significantly participates.
Grouping of Activities

Generally, one or more trade or business activities or rental activities may be treated as a single activity if the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules. Whether activities make up an appropriate economic unit depends on all the relevant facts and circumstances. The factors given the greatest weight in determining whether activities make up an appropriate economic unit are:

1. Similarities and differences in types of trades or businesses.
2. The extent of common control, or
3. The extent of common ownership, or
4. Geographical location, and
5. Reliance between or among the activities.

Example. A corporation has a significant ownership interest in a bakery and a movie theater in Baltimore and in a bakery and a movie theater in Philadelphia. Depending on all the relevant facts and circumstances, there may be more than one reasonable method for grouping the activities. For instance, the following groupings may or may not be permissible:

- A single activity.
- A movie theater activity and a bakery activity.
- A Baltimore activity and a Philadelphia activity.
- Four separate activities.

Once the corporation chooses a grouping under these rules, it must continue using that grouping in later tax years unless either:

- The corporation determines that the original grouping was clearly inappropriate; or
- A material change in the facts and circumstances makes that grouping clearly inappropriate.

The IRS may regroup the corporation's activities if any of the activities resulting from the corporation's grouping violate an appropriate economic unit and one of the primary purposes of the grouping (or failure to regroup as required under Regulations section 1.469-4(e)1 is to avoid the underlying purposes of the passive activity rules.

Limitation on grouping certain activities.

The following activities cannot be grouped together.

1. A rental activity with a trade or business activity unless the activities being grouped together make up an appropriate economic unit and:
   a. The rental activity is insubstantial relative to the trade or business activity or vice versa, or
   b. Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity. If so, the rental activity portion involving the rental of property used in the trade or business activity can be grouped with the trade or business activity.

2. An activity involving the rental of real property with a trade or business activity involving the rental of personal property (except personal property provided in connection with the real property or vice versa).

3. Any activity with another activity in a different line of business and in which the corporation holds an interest as a limited partner or as a limited entrepreneur (as defined in section 464(e)(2)) if that other activity is holding, producing, or distributing motion picture films or videotapes; farming; leasing section 1245 property; or exploring for or developing oil, gas, or geothermal deposits.

Activities conducted through partnerships and other C corporations subject to section 469. Once a partnership or corporation determines its activities under these rules, a partner or shareholder can use these rules to group those activities with:

- Each other,
- Activities conducted directly by the partner or shareholder, or
- Activities conducted through other partnerships or corporations.

A partner or shareholder cannot treat as separate activities those activities grouped together by the partnership or corporation.

Partial disposition of an activity.

The corporation can, for the tax year in which there is a disposition of substantially all of an activity, treat the part disposed of as a separate activity if it can prove with reasonable certainty:

1. The prior year unallowed losses and credits, if any, allocable to the part of the activity disposed of, and
2. The loss and any credits for the year of disposition allocable to the disposed part of the activity.

Disclosure Requirement

The following disclosure requirements for groupings apply for tax years beginning after January 24, 2010. The corporation is required to report to the IRS certain changes that the corporation's groupings that occur during the tax year. For more information on these disclosure requirements, see Revenue Procedure 2010-13, 2010-4 I.R.B. 329, available at www.irs.gov/irb/2010-4_IRB/ar15.html.

New grouping. The corporation must file a written statement with its original income tax return for the first tax year in which two or more activities are originally grouped as a single activity. This statement must provide the names, addresses, and employer identification numbers (EINs), if applicable, for the activities being grouped as a single activity. In addition, the statement must contain a declaration that the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules.

Addition to an existing grouping. The corporation must file a written statement with its original income tax return for the tax year in which the corporation adds a new activity to an existing grouping. The statement must provide the name, address, and EIN, if applicable, for the activity that is being added and for the activities in the existing grouping. The statement must contain a declaration that the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules.

Regrouping. The corporation must file a written statement with its original income tax return for the tax year in which the corporation regroups activities under Regulations section 1.469-4(e)(2). The statement must provide the names, addresses, and EINs, if applicable, for the activities that are being regrouped. If the corporation regroups two or more activities into a single activity, the statement must contain a declaration that the regrouped activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules. In addition, the statement must contain an explanation of why the original grouping was clearly inappropriate or the nature of the material change in the facts and circumstances that made the original grouping clearly inappropriate.

Reporting of pre-existing groupings required only upon change. The corporation is not required to file a written statement reporting the grouping of the trade or business activities and rental activities that have been made for tax years beginning before January 25, 2010 (pre-existing groupings), until the corporation makes a change to the grouping.

Effect of failure to report. If the corporation fails to report these changes, each trade or business activity or rental activity will be treated as a separate activity. The corporation will be considered to have made a timely disclosure if it has filed all affected income tax returns consistent with the claimed grouping and makes the required disclosure on the income tax return for the year in which the corporation first discovered the failure to disclose. If the IRS first discovers the failure to disclose, however, the corporation must have reasonable cause for not making the required disclosure.

Passive Activity Income and Deductions

Take into account only passive activity income and passive activity deductions to figure the corporation's overall gain or overall loss from all passive activities or any passive activity. In figuring the PAL, a corporation can, for the tax year in which it first satisfies the conditions for inclusion of gains and losses from passive activities, treat as a passive activity:

- A single activity.
- A Baltimore activity and a Philadelphia activity.
- A movie theater activity and a bakery activity.
- Four separate activities.

• A rental activity with a trade or business activity unless the activities being grouped together make up an appropriate economic unit and:

- The rental activity is insubstantial relative to the trade or business activity or vice versa, or

- Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity.

• A material change in the facts and circumstances that makes that grouping clearly inappropriate.

The IRS may regroup the corporation's activities if any of the activities resulting from the corporation's grouping violate an appropriate economic unit and one of the primary purposes of the grouping (or failure to regroup as required under Regulations section 1.469-4(e)1 is to avoid the underlying purposes of the passive activity rules.

Disclosure Requirement

The following disclosure requirements for groupings apply for tax years beginning after January 24, 2010. The corporation is required to report to the IRS certain changes that the corporation's groupings that occur during the tax year. For more information on these disclosure requirements, see Revenue Procedure 2010-13, 2010-4 I.R.B. 329, available at www.irs.gov/irb/2010-4_IRB/ar15.html.

New grouping. The corporation must file a written statement with its original income tax return for the first tax year in which two or more activities are originally grouped as a single activity. This statement must provide the names, addresses, and employer identification numbers (EINs), if applicable, for the activities being grouped as a single activity. In addition, the statement must contain a declaration that the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules.

Addition to an existing grouping. The corporation must file a written statement with its original income tax return for the tax year in which the corporation adds a new activity to an existing grouping. The statement must provide the name, address, and EIN, if applicable, for the activity that is being added and for the activities in the existing grouping. The statement must contain a declaration that the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules.

Regrouping. The corporation must file a written statement with its original income tax return for the tax year in which the corporation regroups activities under Regulations section 1.469-4(e)(2). The statement must provide the names, addresses, and EINs, if applicable, for the activities that are being regrouped. If the corporation regroups two or more activities into a single activity, the statement must contain a declaration that the regrouped activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules. In addition, the statement must contain an explanation of why the original grouping was clearly inappropriate or the nature of the material change in the facts and circumstances that made the original grouping clearly inappropriate.

Self-Charged Interest

Certain “self-charged” interest income or expense can be treated as passive activity gross income or passive activity deductions as if the loan proceeds are used in a passive activity. Generally, self-charged interest income and expense result from loans between the corporation and a partnership in which the corporation had a direct or indirect ownership interest. It also may result from loans between one partnership and another if each owner in the borrowing entity has the same proportional ownership interest in the lending entity. The self-charged interest income and expense may not apply to the corporation's partnership interest if the partnership made an election under Regulations section 1.469-7(g) to avoid the application of these rules. See Regulations section 1.469-7 for details.

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)) and Regulations section 1.469-2(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.
• 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 portfolio income or is held for investment (see section 163(d)(5)). See Temporary Regulations section 1.469-2T(c)(3). See Self-Charged Interest above for an exception.
• 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.
• 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 Regulations section 1.469-2(c)(6).
• Any income treated as income not from a passive activity under Temporary Regulations section 1.469-2T(f) and Regulations section 1.469-2(f). See Recharacterization of Passive Income below.
• Overall gain from any interest in a PTP.
• State, local, and foreign income tax refunds.
• Any reimbursement of a casualty or theft loss included in income as recovery of all or part of a prior year loss deduction, if the deduction for the loss was not treated as a passive activity deduction.
• Cancellation of debt income to the extent that at the time the debt was discharged it was not properly allocable under Temporary Regulations section 1.163-8T to passive activities.

Recharacterization of Passive Income

Certain income from passive activities can 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 of these sources (either directly or through a partnership), see Pub. 925 for details on reporting net income or loss from these sources.

Income from the following sources may be subject to the net income recapture rules:
• Significant participation passive activities.
• Any trade or business activity (see Trade or Business Activities, earlier), in which the corporation is treated as having participated for more than 100 hours during the tax year but did not materially participate.
• Rental of property when less than 30% of the unadjusted basis of the property is subject to depreciation.
• Passive equity-financed lending activities.
• Rental of property incidental to a development activity.
• Rental of property to a nonpassive activity.

• Acquisition of an interest in a pass-through entity that licenses intangible property.

Passive Activity Deductions

Passive activity deductions include all deductions from activities that are passive activities for the current year and all deductions from passive activities that were disallowed under the PAL rules in prior tax years and carried forward to the current tax year under section 469(b). See Regulations section 1.469-1(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 below, for the treatment of losses upon 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 or self-charged interest treated as a passive activity deduction (see Self-Charged Interest above). For example, capitalized interest expense is not a passive activity deduction.
  • Losses from dispositions of property that produce 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 other activities other than passive activities. See Temporary Regulations section 1.469-2T(f).
  • Deductions for losses from fire, storm, shipwreck, or other casualty, or from theft, if losses similar in cause and severity do not regularly recur in the activity.

Former Passive Activities

A former passive activity is any activity that was a passive activity in a prior tax year but is not a passive activity in the current tax year. A prior year unallowed loss from a former passive activity is allowed to the extent of current year income from the activity.

If the current year net income from the activity is less than the prior year unallowed loss, enter the prior year unallowed loss and any current year net income from the activity on Form 8810 and the applicable worksheets.

If the current year net income from the activity is more than or equal to the prior year unallowed loss from the activity, report the income and loss on the forms and schedules normally used; do not enter the amounts on Form 8810.

If the activity has a net loss for the current year, enter the prior year unallowed loss (but not the current year loss) on Form 8810 and the applicable worksheets.

For rules about prior year unallowed credits from former passive activities, see section 469(f).

To report a disposition of a former passive activity, follow the rules under Dispositions below.

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 net income or net loss from the activity for the current year.

Note. A disposition of less than substantially all of an entire interest does not trigger the allowance of prior year unallowed losses.

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 PAL rules. A fully taxable transaction is a transaction in which all the realized gain or loss is recognized.

If the corporation is using the installment method to report this kind of disposition, figure the loss for the current year that is not limited by the PAL rules by multiplying the corporation’s overall loss (which does not include losses allowed in prior years) by the following fraction.

\[
\text{Gain recognized in the current year} = \frac{\text{Unrecognized gain as of the beginning of the current year}}{\text{Unallocated gain recognized in the current year}}
\]

Unallowed passive activity credits, unlike unallowed PALs, are not allowable when the corporation disposes of its interest in an activity. However, the corporation can 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 under the passive activity rules. Unallowed activity credits that are not used to increase the basis of the credit property are carried forward until they are allowed. To make the election, complete Part III of Form 8810. No basis adjustment can be elected on a partial disposition of the corporation’s interest in a passive activity.

A partner in a 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 (Form 1120), Capital Gains and Losses, or Form 4797, Sales of Business Property

When the corporation completely disposes of an entire interest in a passive activity or a former passive activity, there may be net income or loss and prior year unallowed losses from the activity. All the income, gains, deductions, and losses are reported on the forms and schedules normally used.

Combine all income, gains, deductions, and losses (including any prior year
unallowed losses) from the activity for the tax year to see if the corporation has an overall gain or loss.

If the corporation has an overall gain from a passive activity and also has other passive activities to report on Form 8810, include the income, gains, deductions, and losses (including prior year unallowed losses) on Worksheet 1. If this is the corporation’s only passive activity or a former passive activity, report the income, gains, deductions, and losses on the forms and schedules normally used, but do not enter them on the worksheets or on Form 8810.

If the corporation has an overall loss when combining all income, gains, deductions, and losses (including any prior year unallowed losses) from the activity, report all the income, gains, deductions, and losses on the forms and schedules normally used, but do not enter them on the worksheets or on Form 8810.

Note. Members of a consolidated group, see Regulations section 1.469-1(h)(6) and Temporary Regulations sections 1.469-1T(h)(7) and (8) for rules on applying the PAL rules to dispositions of property and other intercompany transactions.

Specific Instructions
Note. Complete Worksheets 1 and 2 before completing Part I of Form 8810.

Worksheet 1
Use Worksheet 1 to figure the total current year income, gains, deductions, and losses for each passive activity.

Lines 1 through 4. Enter on these lines the gross receipts and other income from passive activities and passive activity gains reported on Form 4797 and Schedule D (Form 1120).

Line 5. Enter total income on this line and in column (a) of Worksheet 2.

Lines 6a through 6l. Enter passive activity deductions.

Lines 8 and 9. Enter losses from passive activities reported on Schedule D (Form 1120) and Form 4797.

Line 10. Enter total deductions and losses on this line and 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.

Worksheet 2

Columns (a) and (b). Enter in column (a) the total income for the current year shown on line 5 in Worksheet 1. Enter in column (b) the total deductions and losses shown on line 10 in Worksheet 1.

Column (c). Enter the prior year unallowed losses that can be found in Worksheet 4, column (c) of the 2010 Form 8810 instructions.

Totals. The total from columns (a), (b), and (c) of Worksheet 2 are entered on lines 1a, 1b, and 1c of Form 8810.

Columns (d) and (e). 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). Do not enter the amounts in columns (d) and (e) on Form 8810. These amounts will be used when Form 8810 is completed to figure the loss allowed for the current year.

Part I. 2011 Passive Activity Loss (PAL)

Lines 1d and 3
If line 1d or 3 shows net income or zero, all 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, U.S. Corporation Income Tax Return, 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 are properly entered 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 (Form 1120), include the prior year unallowed losses on the appropriate line along with any current year deduction or loss from that line.

**Example.** The corporation had $1,000 of deductions for current year repairs and maintenance and $500 of deductions for prior year unallowed repairs and maintenance. Enter $1,500 as the deduction for repairs and maintenance 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, earlier.
- 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 Regulations section 1.469-2(c)(2)(iii)(F).
- Gross income from certain oil or gas properties treated under Regulations section 1.469-2(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 did not materially participate in the activity for the tax year.

If the corporation disposed of its entire interest in a passive activity to an unrelated party in a fully taxable transaction, figure net active income by taking into account an overall loss from that activity only to the extent it exceeds overall gain from all other passive activities (the gain, if any, shown on line 1d of Form 8810).

If there is an overall loss from all other passive activities (line 1d of Form 8810 is a loss), figure net active income by taking into account all of the overall loss from that activity.

**Line 4. Total Deductions and Losses Allowed**

Columns (d) and (e) of Worksheet 2 show whether an activity had an overall gain or loss.

**Worksheet 2, column (d).** A corporation with an overall gain in column (d) will 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 (Form 1120) or Form 4797, if applicable.

**Worksheet 2, column (e).** A corporation uses Worksheets 3 and 4 for activities that show an overall loss in column (e).

**Worksheet 3.** Use Worksheet 3 to figure the unallowed deductions and losses to be carried forward to Worksheet 4. Use Worksheet 4 to figure the allowed deductions and losses to report on the forms and schedules for 2011.

---

### Worksheet 2 for Form 8810, Lines 1a, 1b, and 1c

<table>
<thead>
<tr>
<th>Name of Activity</th>
<th>Current Year</th>
<th>Prior Year</th>
<th>Overall Gain or Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a) Income</td>
<td>(b) Deductions and Losses</td>
<td>(c) Unallowed Losses</td>
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<td>(Line 1a)</td>
<td>(Line 1b)</td>
<td>(Line 1c)</td>
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<tr>
<td><strong>Totals. Enter on lines 1a, 1b, and 1c of Form 8810</strong></td>
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<td></td>
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</tbody>
</table>
Worksheet 3—Allocation of Unallowed Deductions and Losses

Overall loss in column (e). If the corporation has activities in Worksheet 2 with an overall loss in column (e), use Worksheet 3 to figure the unallowed deductions and losses for each activity.

Overall gain in column (d). 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 (Form 1120), if applicable.

Prior year unallowed losses from 2010. If there were prior year unallowed losses from 2010, include the prior year unallowed losses on the appropriate line along with any current year deduction or loss for that line. See the example in the instructions for lines 1d and 3 above. Prior year unallowed losses from Form 4797 and Schedule D (Form 1120) should have been kept separate in 2010, and should be identified as “prior year unallowed 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 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).

Worksheet 4. Use Worksheet 4 to figure the allowed deductions and losses.

<table>
<thead>
<tr>
<th>Name of Activity</th>
<th>(a) Loss From Worksheet 2, Column (e)</th>
<th>(b) Ratio</th>
<th>(c) Unallowed Deductions and Losses</th>
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<tbody>
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<tr>
<td>Totals</td>
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</tbody>
</table>

Keep for Your Records
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 (Form 1120). 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 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.

<table>
<thead>
<tr>
<th>Form 1120</th>
<th>Schedule D (Form 1120)</th>
<th>Form 4797</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross receipts</td>
<td>$100,000</td>
<td>Gain $1,000</td>
</tr>
<tr>
<td>Deductions</td>
<td>120,000</td>
<td>Loss (2,000)</td>
</tr>
<tr>
<td>Net loss</td>
<td>($20,000)</td>
<td>Net gain</td>
</tr>
</tbody>
</table>

Add the net losses of $20,000 and $1,000, for a total of $21,000. Divide the net loss reported on each form by the total of the net losses, and multiply the result by the unallowed loss of $18,000, as shown below.

Form 1120: $20,000 x $18,000 = $17,143

Schedule D (Form 1120): $21,000 x $18,000 = $857

On Form 4797, report the $2,000 loss and the $5,000 gain. On Worksheet 4, enter the $17,143 of unallowed deductions allocated to Form 1120 in column (c) on the line for total Form 1120 deductions. Enter the $857 of unallowed Schedule D (Form 1120) losses in column (c) of line 2. Use Worksheet 4 to allocate the $17,143 to the Form 1120 deductions and show the allowed and unallowed Schedule D (Form 1120) 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, if line 6i of Worksheet 1 shows current year depreciation for the activity of $2,200, and 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 (Form 1120) losses from line 8 of Worksheet 1 plus any prior year unallowed Schedule D (Form 1120) 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.

Line 1, 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 the ratios must 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, column (c) that is attributable to a Schedule D (Form 1120) 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 (Form 1120) and Form 4797 losses on that form or schedule.

Worksheet 4—Allowed Deductions and Losses

<table>
<thead>
<tr>
<th>Name of Activity:</th>
<th>(a) Deductions and Losses</th>
<th>(b) Ratio</th>
<th>(c) Unallowed Deductions and Losses</th>
<th>(d) Allowed Deductions and Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Form 1120 deductions:</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>a. Cost of goods sold</td>
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<tr>
<td>b. Compensation of officers</td>
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<tr>
<td>c. Salaries and wages</td>
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<tr>
<td>d. Repairs and maintenance</td>
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<td>e. Bad debts</td>
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<td>f. Rents</td>
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<td>g. Taxes and licenses</td>
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<tr>
<td>h. Interest</td>
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<td>i. Depreciation</td>
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<td>j. Depletion</td>
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<td>k. Advertising</td>
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<td>l. Other deductions</td>
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<tr>
<td>Total Form 1120 deductions:</td>
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<td>1.00</td>
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</table>

| 2. Schedule D (Form 1120) losses | | | | |
| 3. Form 4797 losses | | | | |

<table>
<thead>
<tr>
<th>Name of Activity:</th>
<th>(a) Deductions and Losses</th>
<th>(b) Ratio</th>
<th>(c) Unallowed Deductions and Losses</th>
<th>(d) Allowed Deductions and Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Form 1120 deductions:</td>
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<td></td>
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<tr>
<td>a. Cost of goods sold</td>
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<td>b. Compensation of officers</td>
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<td>d. Repairs and maintenance</td>
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<td>e. Bad debts</td>
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<td>f. Rents</td>
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<td>g. Taxes and licenses</td>
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<td>i. Depreciation</td>
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<td>k. Advertising</td>
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<td>l. Other deductions</td>
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<tr>
<td>Total Form 1120 deductions:</td>
<td></td>
<td>1.00</td>
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</table>

| 2. Schedule D (Form 1120) losses | | | | |
| 3. Form 4797 losses | | | | |
Publicly Traded Partnerships (PTPs)

A 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 holders of interests have a readily available, regular, and ongoing opportunity to sell or exchange interests through a public means of obtaining or providing information on offers to buy, sell, or exchange interests. Similarly, the substantial equivalent of a secondary market exists where prospective buyers and sellers have the opportunity to buy, sell, or exchange interests in a timeframe and with the regularity and continuity that the existence of a market maker would provide.

Special Instructions for PTPs

Section 469(k) provides that the PAL limitations must be applied separately to items from each PTP.

Loses 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.

PAL 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 figure and report income, gains, deductions, and losses from passive 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, earlier).

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 in a year in which the corporation disposed of its entire interest in the PTP), 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. 2011 Passive Activity Credits

Use Part II of Form 8810 to figure the amount of credits allowed from passive activities for the current year and the amount that is unallowed and carried forward.

Worksheet 5

Use Worksheet 5 below to figure the amounts to enter on lines 5a and 5b of Form 8810.

Column (a). Convert any current year qualified expenditures into credits and complete Form 3800, General Business Credit, before beginning Worksheet 5. See Cooperatives next for special instructions for certain cooperatives.

Enter the credits from lines 2, 23, and 32 of Form 3800 in column (a) of Worksheet 5. Enter “Form 3800, line followed by the appropriate line number (2, 23, or 32) in the “From Form” column. Separate the credits by activity and by type before making entries in the worksheet. For example, a corporation has a distills spirits credit from each of two passive activities. Enter each distills spirits credit on separate lines in column (a) of Worksheet 5.

Cooperatives. A closely held cooperative that is allocating part or all of a general business credit to patrons will need to enter the credits being allocated on Worksheet 5 so that the passive activity rules can be applied before any part of the credit is allocated to patrons. For this purpose, Form 3800 should be completed using only credits that will not be allocated to patrons. Credits that are being allocated to patrons should be picked up from the separate credit forms.

Column (b). In figuring this year’s passive activity credits, the corporation must take into account any credits from passive activities disallowed for prior years and carried forward to this year adjusted, if required, for items such as recaptured credits (see Regulations section 1.469-3(f)). Enter in column (b) of Worksheet 5 the prior year unallowed credits from column (c) of Worksheet 6 in the 2010 Form 8810 instructions (adjusted if required).

For rules about prior year unallowed credits from former passive activities, see section 469(f).

Line 7

If any of the following apply, enter 0- on line 7 and do not complete Part I or Part II of the Computation for Line 7 below.

- The corporation is a personal service corporation with a loss or zero on line 1d of Form 8810.
- The corporation is a personal service corporation with net passive income on line 1d of Form 8810 and the corporation has an overall loss from the entire disposition of a passive activity that is equal to or greater than the net income on line 1d.
- The corporation is a closely held corporation with a loss or zero on line 1d of Form 8810 and that amount is equal to or greater than the net active income on line 2 of Form 8810.
- The corporation is a closely held corporation with net income on line 3 of Form 8810, and the corporation has an overall loss from an entire disposition that is

<table>
<thead>
<tr>
<th>Name of Activity</th>
<th>From Form</th>
<th>(a) Current Year Credits (Line 5a)</th>
<th>(b) Prior Year Unallowed Credits (Line 5b)</th>
<th>(c) Total Credits (Add Columns (a) and (b))</th>
</tr>
</thead>
<tbody>
<tr>
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<tr>
<td>Totals. Enter on lines 5a and 5b of Form 8810</td>
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</tbody>
</table>
equal to or greater than the net income on line 3.

Computation for Line 7, Part I. This part is used by personal service corporations and closely held corporations with net passive income.

Computation for Line 7, Part II. This part is used by closely held corporations that have net active income. See the line 2 instructions, earlier, 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 computation for line 7, it is not necessary to refigure 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 figuring the tax attributable amounts. Also, see how to figure tax in the instructions for the tax return filed.

Line C. Enter the net income, if any, from line 1d of Form 8810. If the corporation has 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 J. If the corporation has 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.

Worksheet 6—Allowed and Unallowed Credits

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 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 2011. Keep a record of these amounts, so the credits can be carried to the next year.

Column (d). Subtract column (c) from column (a). These are the allowed credits for 2011. The amounts in this column should be reported on Form 3800. See Reporting Allowed Credits on Tax Return, earlier.

Instructions for Form 8810 (2011)
Part III. Election To Increase Basis of Credit Property

Line 10
Check the box on this line if the corporation elects to increase the basis of credit property it used in a passive activity or former passive activity by the unallowed credit that reduced the property’s basis.

The election is available for a fully taxable disposition of an entire interest in an activity for which a basis adjustment was made as a result of placing in service property for which a credit was taken. The corporation can elect to increase the basis of the credit property immediately before the disposition (by an amount no greater than the amount of the original basis reduction) to the extent that the credit has not previously been allowed because of the passive credit limitations. The amount of the unallowed credit that can then be applied against tax is reduced by the amount of the basis adjustment.

No basis adjustment can be elected on a partial disposition of the corporation’s interest in a passive activity or if the disposition is not fully taxable. The amount of any unallowed credit, however, may remain available to offset the tax attributable to net passive and net active income.

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.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

<table>
<thead>
<tr>
<th>Activity</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recordkeeping</td>
<td>26 hr., 18 min.</td>
</tr>
<tr>
<td>Learning about the law or the form</td>
<td>5 hr., 15 min.</td>
</tr>
<tr>
<td>Preparing and sending the form to the IRS</td>
<td>5 hr., 55 min.</td>
</tr>
</tbody>
</table>

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.