

cluded in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

Section 5041(e) of Pub. L. 100-647, as amended by Pub. L. 101-239, title VII, § 7815(e)(3), Dec. 19, 1989, 103 Stat. 2419, provided that:

“(1) SUBSECTIONS (a), (b), AND (c).—

“(A) IN GENERAL.—Except as otherwise provided in this paragraph, the amendments made by subsections (a), (b), and (c) [amending this section and section 56 of this title] shall apply to contracts entered into on or after June 21, 1988.

“(B) BINDING BIDS.—The amendments made by subsections (a), (b), and (c) shall not apply to any contract resulting from the acceptance of a bid made before June 21, 1988. The preceding sentence shall apply only if the bid could not have been revoked or altered at any time on or after June 21, 1988.

“(C) SPECIAL RULE FOR CERTAIN SHIP CONTRACTS.—The amendments made by subsections (a) and (b) [amending this section and section 56 of this title] shall not apply in the case of a qualified ship contract (as defined in section 10203(b)(2)(B) of the Revenue Act of 1987 [Pub. L. 100-203, set out below]).

“(2) SUBSECTION (d).—The amendment made by subsection (d) [amending this section] shall apply as if included in the amendments made by section 804 of the Reform Act [Pub. L. 99-514]; except that such amendment shall not apply to any contract completed in a taxable year ending before the date of the enactment of this Act [Nov. 10, 1988], if the due date (determined with regard to extensions) for the return for such year is before such date of enactment.”

EFFECTIVE DATE OF 1987 AMENDMENT

Section 10203(b) of Pub. L. 100-203 provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section [amending this section] shall apply to contracts entered into after October 13, 1987.

“(2) SPECIAL RULE FOR CERTAIN SHIP CONTRACTS.—

“(A) IN GENERAL.—The amendments made by this section shall not apply in the case of a qualified ship contract.

“(B) QUALIFIED SHIP CONTRACT.—For purposes of subparagraph (A), the term ‘qualified ship contract’ means any contract for the construction in the United States of not more than 5 ships if—

“(i) such ships will not be constructed (directly or indirectly) for the Federal Government, and

“(ii) the taxpayer reasonably expects to complete such contract within 5 years of the contract commencement date (as defined in section 460(g) of the Internal Revenue Code of 1986).”

EFFECTIVE DATE OF 1986 AMENDMENT

Section 804(d) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, § 1008(c)(3), Nov. 10, 1988, 102 Stat. 3439, provided that:

“(1) IN GENERAL.—The amendments made by this section [enacting this section] shall apply to any contract entered into after February 28, 1986.

“(2) CLARIFICATION OF TREATMENT OF INDEPENDENT RESEARCH AND DEVELOPMENT EXPENSES.—

“(A) IN GENERAL.—For periods before, on, or after the date of enactment of this Act [Oct. 22, 1986]—

“(i) any independent research and development expenses taken into account in determining the total contract price shall not be severable from the contract, and

“(ii) any independent research and development expenses shall not be treated as amounts chargeable to capital account.

“(B) INDEPENDENT RESEARCH AND DEVELOPMENT EXPENSES.—For purposes of subparagraph (A), the term ‘independent research and development expenses’ has the meaning given to such term by section 460(c)(5) of the Internal Revenue Code of 1986, as added by this section.”

REGULATIONS

Section 804(b) of Pub. L. 99-514 provided that: “The Secretary of the Treasury or his delegate shall modify the income tax regulations relating to accounting for long-term contracts to carry out the provisions of section 460 of the Internal Revenue Code of 1986 (as added by subsection (a)).”

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

METHOD OF ACCOUNTING FOR NAVAL SHIPBUILDERS

Pub. L. 108-357, title VII, § 708, Oct. 22, 2004, 118 Stat. 1550, as amended by Pub. L. 109-135, title IV, § 403(s), Dec. 21, 2005, 119 Stat. 2628, provided that:

“(a) IN GENERAL.—In the case of a qualified naval ship contract, the taxable income of such contract during the 5-taxable year period beginning with the taxable year in which the construction commencement date occurs shall be determined under a method identical to the method used in the case of a qualified ship contract (as defined in section 10203(b)(2)(B) of the Revenue Act of 1987 [Pub. L. 100-203, set out as an Effective Date of 1987 Amendment note above]).

“(b) RECAPTURE OF TAX BENEFIT.—In the case of a qualified naval ship contract to which subsection (a) applies, the taxpayer’s tax imposed by chapter 1 of the Internal Revenue Code of 1986 for the first taxable year following the 5-taxable year period described in subsection (a) shall be increased by the excess (if any) of—

“(1) the amount of tax which would have been imposed during such period if this section had not been enacted, over

“(2) the amount of tax so imposed during such period.

“(c) QUALIFIED NAVAL SHIP CONTRACT.—For purposes of this section:

“(1) IN GENERAL.—The term ‘qualified naval ship contract’ means any contract or portion thereof that is for the construction in the United States of 1 ship or submarine for the Federal Government if the taxpayer reasonably expects the acceptance date will occur no later than 9 years after the construction commencement date.

“(2) ACCEPTANCE DATE.—The term ‘acceptance date’ means the date 1 year after the date on which the Federal Government issues a letter of acceptance or other similar document for the ship or submarine.

“(3) CONSTRUCTION COMMENCEMENT DATE.—The term ‘construction commencement date’ means the date on which the physical fabrication of any section or component of the ship or submarine begins in the taxpayer’s shipyard.

“(d) CERTAIN ADJUSTMENTS NOT TO APPLY.—Section 481 of the Internal Revenue Code of 1986 shall not apply with respect to any change in the method of accounting which is required by this section.

“(e) EFFECTIVE DATE.—This section shall apply to contracts for ships or submarines with respect to which the construction commencement date occurs after the date of the enactment of this Act [Oct. 22, 2004].”

AMORTIZATION OF PAST SERVICE PENSION COSTS

Allocable costs (within the meaning of subsec. (c) of this section) with respect to any property to include contributions paid to or under a pension or annuity plan whether or not such contributions represent past service costs, see section 10204 of Pub. L. 100-203, set out as a note under section 263A of this title.

SUBPART C—TAXABLE YEAR FOR WHICH DEDUCTIONS TAKEN

Sec.

461. General rule for taxable year of deduction.

Sec.	
[462, 463.]	Repealed.]
464.	Limitations on deductions for certain farming expenses. ¹
465.	Deductions limited to amount at risk.
[466.]	Repealed.]
467.	Certain payments for the use of property or services.
468.	Special rules for mining and solid waste reclamation and closing costs.
468A.	Special rules for nuclear decommissioning costs.
468B.	Special rules for designated settlement funds.
469.	Passive activity losses and credits limited.
470.	Limitation on deductions allocable to property used by governments or other tax-exempt entities.

AMENDMENTS

2004—Pub. L. 108-357, title VIII, §848(b), Oct. 22, 2004, 118 Stat. 1606, added item 470.

1987—Pub. L. 100-203, title X, §10201(b)(7), Dec. 22, 1987, 101 Stat. 1330-387, struck out item 463 "Accrual of vacation pay".

1986—Pub. L. 99-514, title IV, §404(b)(2), title V, §501(b), title VIII, §823(b)(2), title XVIII, §§1807(a)(7)(B), 1899A(71), Oct. 22, 1986, 100 Stat. 2224, 2241, 2374, 2815, 2963, substituted "for certain farming expenses" for "in case of farming syndicates" in item 464, struck out item 466 "Qualified discount coupons redeemed after close of taxable year", inserted "the" before "use" in item 467, and added items 468B and 469.

1984—Pub. L. 98-369, div. A, title I, §§91(b)(2), (c)(2), 92(b), July 18, 1984, 98 Stat. 604, 606, 612, added items 467, 468, and 468A.

1978—Pub. L. 95-600, title II, §201(c)(2), title III, §373(b), Nov. 6, 1978, 92 Stat. 2816, 2865, struck out "in case of certain activities" after "amount at risk" in item 465 and added item 466.

1976—Pub. L. 94-455, title II, §§204(b), 207(a)(2), Oct. 4, 1976, 90 Stat. 1532, 1537, added items 464 and 465.

1975—Pub. L. 93-625, §4(b), Jan. 3, 1975, 88 Stat. 2111, added item 463.

1955—Act June 15, 1955, ch. 143, §2(3), 69 Stat. 135, struck out item 462 "Reserves for estimated expenses, etc."

§ 461. General rule for taxable year of deduction**(a) General rule**

The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

(b) Special rule in case of death

In the case of the death of a taxpayer whose taxable income is computed under an accrual method of accounting, any amount accrued as a deduction or credit only by reason of the death of the taxpayer shall not be allowed in computing taxable income for the period in which falls the date of the taxpayer's death.

(c) Accrual of real property taxes**(1) In general**

If the taxable income is computed under an accrual method of accounting, then, at the election of the taxpayer, any real property tax which is related to a definite period of time shall be accrued ratably over that period.

(2) When election may be made**(A) Without consent**

A taxpayer may, without the consent of the Secretary, make an election under this

subsection for his first taxable year in which he incurs real property taxes. Such an election shall be made not later than the time prescribed by law for filing the return for such year (including extensions thereof).

(B) With consent

A taxpayer may, with the consent of the Secretary, make an election under this subsection at any time.

(d) Limitation on acceleration of accrual of taxes**(1) General rule**

In the case of a taxpayer whose taxable income is computed under an accrual method of accounting, to the extent that the time for accruing taxes is earlier than it would be but for any action of any taxing jurisdiction taken after December 31, 1960, then, under regulations prescribed by the Secretary, such taxes shall be treated as accruing at the time they would have accrued but for such action by such taxing jurisdiction.

(2) Limitation

Under regulations prescribed by the Secretary, paragraph (1) shall be inapplicable to any item of tax to the extent that its application would (but for this paragraph) prevent all persons (including successors in interest) from ever taking such item into account.

(e) Dividends or interest paid on certain deposits or withdrawable accounts

Except as provided in regulations prescribed by the Secretary, amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts (if such amounts paid or credited are withdrawable on demand subject only to customary notice to withdraw) by a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative bank shall not be allowed as a deduction for the taxable year to the extent such amounts are paid or credited for periods representing more than 12 months. Any such amount not allowed as a deduction as the result of the application of the preceding sentence shall be allowed as a deduction for such other taxable year as the Secretary determines to be consistent with the preceding sentence.

(f) Contested liabilities

If—

(1) the taxpayer contests an asserted liability,

(2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability,

(3) the contest with respect to the asserted liability exists after the time of the transfer, and

(4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year) determined after application of subsection (h),

then the deduction shall be allowed for the taxable year of the transfer. This subsection shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by

¹ So in original. Does not conform to section catchline.

the authority of any foreign country or possession of the United States.

(g) Prepaid interest

(1) In general

If the taxable income of the taxpayer is computed under the cash receipts and disbursements method of accounting, interest paid by the taxpayer which, under regulations prescribed by the Secretary, is properly allocable to any period—

(A) with respect to which the interest represents a charge for the use or forbearance of money, and

(B) which is after the close of the taxable year in which paid,

shall be charged to capital account and shall be treated as paid in the period to which so allocable.

(2) Exception

This subsection shall not apply to points paid in respect of any indebtedness incurred in connection with the purchase or improvement of, and secured by, the principal residence of the taxpayer to the extent that, under regulations prescribed by the Secretary, such payment of points is an established business practice in the area in which such indebtedness is incurred, and the amount of such payment does not exceed the amount generally charged in such area.

(h) Certain liabilities not incurred before economic performance

(1) In general

For purposes of this title, in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

(2) Time when economic performance occurs

Except as provided in regulations prescribed by the Secretary, the time when economic performance occurs shall be determined under the following principles:

(A) Services and property provided to the taxpayer

If the liability of the taxpayer arises out of—

(i) the providing of services to the taxpayer by another person, economic performance occurs as such person provides such services,

(ii) the providing of property to the taxpayer by another person, economic performance occurs as the person provides such property, or

(iii) the use of property by the taxpayer, economic performance occurs as the taxpayer uses such property.

(B) Services and property provided by the taxpayer

If the liability of the taxpayer requires the taxpayer to provide property or services, economic performance occurs as the taxpayer provides such property or services.

(C) Workers compensation and tort liabilities of the taxpayer

If the liability of the taxpayer requires a payment to another person and—

(i) arises under any workers compensation act, or

(ii) arises out of any tort,

economic performance occurs as the payments to such person are made. Subparagraphs (A) and (B) shall not apply to any liability described in the preceding sentence.

(D) Other items

In the case of any other liability of the taxpayer, economic performance occurs at the time determined under regulations prescribed by the Secretary.

(3) Exception for certain recurring items

(A) In general

Notwithstanding paragraph (1) an item shall be treated as incurred during any taxable year if—

(i) the all events test with respect to such item is met during such taxable year (determined without regard to paragraph (1)),

(ii) economic performance with respect to such item occurs within the shorter of—

(I) a reasonable period after the close of such taxable year, or

(II) 8½ months after the close of such taxable year,

(iii) such item is recurring in nature and the taxpayer consistently treats items of such kind as incurred in the taxable year in which the requirements of clause (i) are met, and

(iv) either—

(I) such item is not a material item, or

(II) the accrual of such item in the taxable year in which the requirements of clause (i) are met results in a more proper match against income than accruing such item in the taxable year in which economic performance occurs.

(B) Financial statements considered under subparagraph (A)(iv)

In making a determination under subparagraph (A)(iv), the treatment of such item on financial statements shall be taken into account.

(C) Paragraph not to apply to workers compensation and tort liabilities

This paragraph shall not apply to any item described in subparagraph (C) of paragraph (2).

(4) All events test

For purposes of this subsection, the all events test is met with respect to any item if all events have occurred which determine the fact of liability and the amount of such liability can be determined with reasonable accuracy.

(5) Subsection not to apply to certain items

This subsection shall not apply to any item for which a deduction is allowable under a pro-

vision of this title which specifically provides for a deduction for a reserve for estimated expenses.

(i) Special rules for tax shelters

(1) Recurring item exception not to apply

In the case of a tax shelter, economic performance shall be determined without regard to paragraph (3) of subsection (h).

(2) Special rule for spudding of oil or gas wells

(A) In general

In the case of a tax shelter, economic performance with respect to amounts paid during the taxable year for drilling an oil or gas well shall be treated as having occurred within a taxable year if drilling of the well commences before the close of the 90th day after the close of the taxable year.

(B) Deduction limited to cash basis

(i) Tax shelter partnerships

In the case of a tax shelter which is a partnership, in applying section 704(d) to a deduction or loss for any taxable year attributable to an item which is deductible by reason of subparagraph (A), the term “cash basis” shall be substituted for the term “adjusted basis”.

(ii) Other tax shelters

Under regulations prescribed by the Secretary, in the case of a tax shelter other than a partnership, the aggregate amount of the deductions allowable by reason of subparagraph (A) for any taxable year shall be limited in a manner similar to the limitation under clause (i).

(C) Cash basis defined

For purposes of subparagraph (B), a partner’s cash basis in a partnership shall be equal to the adjusted basis of such partner’s interest in the partnership, determined without regard to—

- (i) any liability of the partnership, and
- (ii) any amount borrowed by the partner with respect to such partnership which—
 - (I) was arranged by the partnership or by any person who participated in the organization, sale, or management of the partnership (or any person related to such person within the meaning of section 465(b)(3)(C)), or
 - (II) was secured by any asset of the partnership.

(3) Tax shelter defined

For purposes of this subsection, the term “tax shelter” means—

- (A) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale,
- (B) any syndicate (within the meaning of section 1256(e)(3)(B)), and
- (C) any tax shelter (as defined in section 6662(d)(2)(C)(ii)).

(4) Special rules for farming

In the case of the trade or business of farming (as defined in section 464(e)), in determin-

ing whether an entity is a tax shelter, the definition of farming syndicate in section 464(c) shall be substituted for subparagraphs (A) and (B) of paragraph (3).

(5) Economic performance

For purposes of this subsection, the term “economic performance” has the meaning given such term by subsection (h).

(j) Limitation on excess farm losses of certain taxpayers

(1) Limitation

If a taxpayer other than a C corporation receives any applicable subsidy for any taxable year, any excess farm loss of the taxpayer for the taxable year shall not be allowed.

(2) Disallowed loss carried to next taxable year

Any loss which is disallowed under paragraph (1) shall be treated as a deduction of the taxpayer attributable to farming businesses in the next taxable year.

(3) Applicable subsidy

For purposes of this subsection, the term “applicable subsidy” means—

- (A) any direct or counter-cyclical payment under title I of the Food, Conservation, and Energy Act of 2008, or any payment elected to be received in lieu of any such payment, or
- (B) any Commodity Credit Corporation loan.

(4) Excess farm loss

For purposes of this subsection—

(A) In general

The term “excess farm loss” means the excess of—

- (i) the aggregate deductions of the taxpayer for the taxable year which are attributable to farming businesses of such taxpayer (determined without regard to whether or not such deductions are disallowed for such taxable year under paragraph (1)), over
- (ii) the sum of—
 - (I) the aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such farming businesses, plus
 - (II) the threshold amount for the taxable year.

(B) Threshold amount

(i) In general

The term “threshold amount” means, with respect to any taxable year, the greater of—

- (I) \$300,000 (\$150,000 in the case of married individuals filing separately), or
- (II) the excess (if any) of the aggregate amounts described in subparagraph (A)(ii)(I) for the 5-consecutive taxable year period preceding the taxable year over the aggregate amounts described in subparagraph (A)(i) for such period.

(ii) Special rules for determining aggregate amounts

For purposes of clause (i)(II)—

(I) notwithstanding the disregard in subparagraph (A)(i) of any disallowance under paragraph (1), in the case of any loss which is carried forward under paragraph (2) from any taxable year, such loss (or any portion thereof) shall be taken into account for the first taxable year in which a deduction for such loss (or portion) is not disallowed by reason of this subsection, and

(II) the Secretary shall prescribe rules for the computation of the aggregate amounts described in such clause in cases where the filing status of the taxpayer is not the same for the taxable year and each of the taxable years in the period described in such clause.

(C) Farming business

(i) In general

The term “farming business” has the meaning given such term in section 263A(e)(4).

(ii) Certain trades and businesses included

If, without regard to this clause, a taxpayer is engaged in a farming business with respect to any agricultural or horticultural commodity—

(I) the term “farming business” shall include any trade or business of the taxpayer of the processing of such commodity (without regard to whether the processing is incidental to the growing, raising, or harvesting of such commodity), and

(II) if the taxpayer is a member of a cooperative to which subchapter T applies, any trade or business of the cooperative described in subclause (I) shall be treated as the trade or business of the taxpayer.

(D) Certain losses disregarded

For purposes of subparagraph (A)(i), there shall not be taken into account any deduction for any loss arising by reason of fire, storm, or other casualty, or by reason of disease or drought, involving any farming business.

(5) Application of subsection in case of partnerships and S corporations

In the case of a partnership or S corporation—

(A) this subsection shall be applied at the partner or shareholder level, and

(B) each partner’s or shareholder’s proportionate share of the items of income, gain, or deduction of the partnership or S corporation for any taxable year from farming businesses attributable to the partnership or S corporation, and of any applicable subsidies received by the partnership or S corporation during the taxable year, shall be taken into account by the partner or shareholder in applying this subsection to the taxable year of such partner or shareholder with or within which the taxable year of the partnership or S corporation ends.

The Secretary may provide rules for the application of this paragraph to any other pass-

thru entity to the extent necessary to carry out the provisions of this subsection.

(6) Additional reporting

The Secretary may prescribe such additional reporting requirements as the Secretary determines appropriate to carry out the purposes of this subsection.

(7) Coordination with section 469

This subsection shall be applied before the application of section 469.

(Aug. 16, 1954, ch. 736, 68A Stat. 157; Pub. L. 86-781, §6(a), Sept. 14, 1960, 74 Stat. 1020; Pub. L. 87-876, §3(a), Oct. 24, 1962, 76 Stat. 1199; Pub. L. 88-272, title II, §223(a)(1), Feb. 26, 1964, 78 Stat. 76; Pub. L. 94-455, title II, §208(a), title XIX, §§1901(a)(69), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1541, 1775, 1834; Pub. L. 98-369, div. A, title I, §91(a), (e), July 18, 1984, 98 Stat. 598, 607; Pub. L. 99-514, title VIII, §§801(b), 805(c)(5), 823(b)(1), title XVIII, §1807(a)(1), (2), Oct. 22, 1986, 100 Stat. 2347, 2362, 2374, 2811; Pub. L. 100-203, title X, §10201(b)(5), Dec. 22, 1987, 101 Stat. 1330-387; Pub. L. 100-647, title I, §§1008(a)(3), 1018(u)(5), Nov. 10, 1988, 102 Stat. 3436, 3590; Pub. L. 101-239, title VII, §7721(c)(10), Dec. 19, 1989, 103 Stat. 2400; Pub. L. 101-508, title XI, §11704(a)(5), Nov. 5, 1990, 104 Stat. 1388-518; Pub. L. 104-188, title I, §1704(t)(24), (78), Aug. 20, 1996, 110 Stat. 1888, 1891; Pub. L. 109-135, title IV, §412(aa), Dec. 21, 2005, 119 Stat. 2638; Pub. L. 110-234, title XV, §15351(a), May 22, 2008, 122 Stat. 1523; Pub. L. 110-246, §4(a), title XV, §15351(a), June 18, 2008, 122 Stat. 1664, 2285.)

REFERENCES IN TEXT

The Food, Conservation, and Energy Act of 2008, referred to in subsec. (j)(3)(A), is Pub. L. 110-246, June 18, 2008, 122 Stat. 1651. Title I of the Act is classified principally to chapter 113 (§8701 et seq.) of Title 7, Agriculture. For complete classification of this Act to the Code, see Short Title note set out under section 8701 of Title 7 and Tables.

CODIFICATION

Pub. L. 110-234 and Pub. L. 110-246 made identical amendments to this section. The amendments by Pub. L. 110-234 were repealed by section 4(a) of Pub. L. 110-246.

AMENDMENTS

2008—Subsec. (j). Pub. L. 110-246, §15351(a), added subsec. (j).

2005—Subsec. (i)(3)(C). Pub. L. 109-135 substituted “section 6662(d)(2)(C)(ii)” for “section 6662(d)(2)(C)(iii)”.

1996—Subsec. (i)(3)(C). Pub. L. 104-188, §1704(t)(78), substituted “section 6662(d)(2)(C)(iii)” for “section 6662(d)(2)(C)(ii)”.

Pub. L. 104-188, §1704(t)(24), amended directory language of Pub. L. 101-239. See 1989 Amendment note below.

1990—Subsec. (i)(3)(C). Pub. L. 101-508 amended subpar. (C) generally. Prior to amendment, subpar. (C) read as follows: “any tax shelter (within the meaning of section 6662(d)(2)(C)(ii)).”

1989—Subsec. (i)(3)(C). Pub. L. 101-239, as amended by Pub. L. 104-188, §1704(t)(24), substituted “section 6662(d)(2)(C)(ii)” for “section 6661(b)(2)(C)(ii)”.

1988—Subsec. (h)(5)(B), (C). Pub. L. 100-647, §1018(u)(5), amended Pub. L. 99-514, §823(b)(1). See 1986 Amendment note below.

Subsec. (i)(2). Pub. L. 100-647, §1008(a)(3), amended par. (2) generally. Prior to amendment, par. (2) read as follows: “In the case of a tax shelter, economic performance with respect to the act of drilling an oil or

gas well shall be treated as having occurred within a taxable year if drilling of the well commences before the close of the 90th day after the close of the taxable year.”

1987—Subsec. (h)(5). Pub. L. 100-203 substituted “items” for “cases to which other provisions of this title specifically apply” in heading and amended text generally. Prior to amendment, text read as follows: “This subsection shall not apply to any item to which any of the following provisions apply:

“(A) Section 463 (relating to vacation pay).

“(B) Any other provisions of this title which specifically provides for a deduction for a reserve for estimated expenses.”

1986—Subsec. (h)(5)(A). Pub. L. 99-514, §805(c)(5), redesignated subpar. (B) as (A) and struck out former subpar. (A) which referred to subsec. (c) or (f) of section 166.

Subsec. (h)(5)(B). Pub. L. 99-514, §823(b)(1), as amended by Pub. L. 100-647, §1018(u)(5), redesignated subpar. (C) as (B) and struck out former subpar. (B) which read as follows: “Section 466 (relating to discount coupons).”

Pub. L. 99-514, §805(c)(5), redesignated subpar. (C) as (B). Former subpar. (B) redesignated (A).

Subsec. (h)(5)(C). Pub. L. 99-514, §823(b)(1), as amended by Pub. L. 100-647, §1018(u)(5), redesignated subpar. (C) as (B).

Pub. L. 99-514, §805(c)(5), redesignated subpar. (D) as (C). Former subpar. (C) redesignated (B).

Subsec. (h)(5)(D). Pub. L. 99-514, §805(c)(5), redesignated subpar. (D) as (C).

Subsec. (i). Pub. L. 99-514, §801(b)(1), substituted “Special rules for tax shelters” for “Tax shelters may not deduct items earlier than when economic performance occurs” in heading.

Subsec. (i)(1). Pub. L. 99-514, §801(b)(1), substituted “Recurring item exception not to apply” for “In general” in heading and amended par. (1) generally. Prior to amendment, par. (1) read as follows: “In the case of a tax shelter computing taxable income under the cash receipts and disbursements method of accounting, such tax shelter shall not be allowed a deduction under this chapter with respect to any item any earlier than the time when such item would be treated as incurred under subsection (h) (determined without regard to paragraph (3) thereof).”

Subsec. (i)(2). Pub. L. 99-514, §801(b)(1), amended par. (2) generally, substituting provisions relating to special rule for spudding of oil or gas wells for former provisions consisting of subpars. (A) to (D) which related to deduction of items when economic performance occurs on or before 90th day after close of the taxable year to the extent of cash basis.

Pub. L. 99-514, §1807(a)(1), substituted “on or before the 90th day” for “within 90 days” in heading and substituted “before the close of the 90th day after the close of the taxable year” for “within 90 days after the close of the taxable year” in subpar. (A).

Subsec. (i)(4). Pub. L. 99-514, §801(b)(2), amended par. (4) generally. Prior to amendment, par. (4) read as follows: “In the case of the trade or business of farming (as defined in section 464(e))—

“(A) any tax shelter described in paragraph (3)(C) shall be treated as a farming syndicate for purposes of section 464; except that this subparagraph shall not apply for purposes of determining the income of an individual meeting the requirements of section 464(c)(2),

“(B) section 464 shall be applied before this subsection, and

“(C) in determining whether an entity is a tax shelter, the definition of farming syndicate in section 464(c) shall be substituted for subparagraphs (A) and (B) of paragraph (3).”

Subsec. (i)(4)(A). Pub. L. 99-514, §1807(a)(2), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: “section 464 shall be applied to any tax shelter described in paragraph (3)(C).”

1984—Subsec. (f)(4). Pub. L. 98-369, §91(e), inserted “determined after application of subsection (h)”.

Subsecs. (h), (i). Pub. L. 98-369, §91(a), added subsecs. (h) and (i).

1976—Subsec. (c)(2), (3). Pub. L. 94-455, §§1901(a)(69)(A), (B), 1906(b)(13)(A), redesignated par. (3) as (2), substituted “in which he” for “which begins after December 31, 1953, and ends after the date of the enactment of this title in which the taxpayer”, and struck out “or his delegate” after “Secretary” wherever appearing. Former par. (2), which related to special limitations on the applicability of par. (1), was struck out.

Subsecs. (d), (e). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary” wherever appearing.

Subsec. (g). Pub. L. 94-455, §208(a), added subsec. (g).

1964—Subsec. (f). Pub. L. 88-272 added subsec. (f).

1962—Subsec. (e). Pub. L. 87-876 added subsec. (e).

1960—Subsec. (d). Pub. L. 86-781 added subsec. (d).

EFFECTIVE DATE OF 2008 AMENDMENT

Amendment of this section and repeal of Pub. L. 110-234 by Pub. L. 110-246 effective May 22, 2008, the date of enactment of Pub. L. 110-234, except as otherwise provided, see section 4 of Pub. L. 110-246, set out as an Effective Date note under section 8701 of Title 7, Agriculture.

Pub. L. 110-234, title XV, §15351(b), May 22, 2008, 122 Stat. 1525, and Pub. L. 110-246, §4(a), title XV, §15351(b), June 18, 2008, 122 Stat. 1664, 2287, provided that: “The amendment made by this section [amending this section] shall apply to taxable years beginning after December 31, 2009.”

[Pub. L. 110-234 and Pub. L. 110-246 enacted identical provisions. Pub. L. 110-234 was repealed by section 4(a) of Pub. L. 110-246, set out as a note under section 8701 of Title 7, Agriculture.]

EFFECTIVE DATE OF 1989 AMENDMENT

Section 7721(d) of Pub. L. 101-239 provided that: “The amendments made by this section [enacting sections 6662 to 6665 of this title, amending this section and sections 1274, 5684, 5761, 6013, 6222, 6601, 6621, 6653, 6672, and 7519 of this title, and repealing sections 6659, 6659A, 6660, 6661, and former section 6662 of this title] shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1989.”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1987 AMENDMENT

Amendment by Pub. L. 100-203 applicable to taxable years beginning after Dec. 31, 1987, see section 10201(c)(1) of Pub. L. 100-203, set out as a note under section 404 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 801(b) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 801(d) of Pub. L. 99-514, set out as an Effective Date note under section 448 of this title.

Amendment by section 805(c)(5) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, with certain changes required in method of accounting, see section 805(d) of Pub. L. 99-514, set out as a note under section 166 of this title.

Amendment by section 823 of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, with changes required in the method of accounting, see section 823(c) of Pub. L. 99-514, set out as an Effective Date of Repeal note under section 466 of this title.

Amendment by section 1807(a)(1), (2) of Pub. L. 99-514 effective, except as otherwise provided, as if included in

the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 91(g)-(i) of Pub. L. 98-369, as amended by Pub. L. 99-514, § 2, title XVIII, § 1807(a)(3)(B), (4)(F), (5), (6), Oct. 22, 1986, 100 Stat. 2095, 2811, 2813, 2814, provided that:

“(g) EFFECTIVE DATES.—

“(1) IN GENERAL.—Except as provided in this subsection and subsections (h) and (i), the amendments made by this section [enacting sections 88, 468, and 468A of this title and amending this section and section 172 of this title] shall apply to amounts with respect to which a deduction would be allowable under chapter 1 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (determined without regard to such amendments) after—

“(A) in the case of amounts to which section 461(h) of such Code (as added by such amendments) applies, the date of the enactment of this Act [July 18, 1984], and

“(B) in the case of amounts to which section 461(i) of such Code (as so added) applies, after March 31, 1984.

“(2) TAXPAYER MAY ELECT EARLIER APPLICATION.—

“(A) IN GENERAL.—In the case of amounts described in paragraph (1)(A), a taxpayer may elect to have the amendments made by this section apply to amounts which—

“(i) are incurred on or before the date of the enactment of this Act [July 18, 1984] (determined without regard to such amendments), and

“(ii) are incurred after the date of the enactment of this Act (determined with regard to such amendments).

The Secretary of the Treasury or his delegate may by regulations provide that (in lieu of an election under the preceding sentence) a taxpayer may (subject to such conditions as such regulations may provide) elect to have subsection (h) of section 461 of such Code apply to the taxpayer's entire taxable year in which occurs July 19, 1984.

“(B) ELECTION TREATED AS CHANGE IN THE METHOD OF ACCOUNTING.—For purposes of section 481 of the Internal Revenue Code of 1986, if an election is made under subparagraph (A) with respect to any amount, the application of the amendments made by this section shall be treated as a change in method of accounting—

“(i) initiated by the taxpayer,

“(ii) made with the consent of the Secretary of the Treasury, and

“(iii) with respect to which section 481 of such Code shall be applied by substituting a 3-year adjustment period for a 10-year adjustment period.

“(3) SECTION 461(h) TO APPLY IN CERTAIN CASES.—Notwithstanding paragraph (1), section 461(h) of the Internal Revenue Code of 1986 (as added by this section) shall be treated as being in effect to the extent necessary to carry out any amendments made by this section which take effect before section 461(h).

“(4) EFFECTIVE DATE FOR TREATMENT OF MINING AND SOLID WASTE RECLAMATION AND CLOSING COSTS.—Except as otherwise provided in subsection (h), the amendments made by subsection (b) [enacting section 468 of this title] shall take effect on the date of the enactment of this Act [July 18, 1984] with respect to taxable years ending after such date.

“(5) RULES FOR NUCLEAR DECOMMISSIONING COSTS.—The amendments made by subsections (c) and (f) [enacting sections 88 and 468A of this title] shall take effect on the date of the enactment of this Act [July 18, 1984] with respect to taxable years ending after such date.

“(6) MODIFICATION OF NET OPERATING LOSS CARRY-BACK PERIOD.—The amendments made by subsection (d) [amending section 172 of this title] shall apply to

losses for taxable years beginning after December 31, 1983.

“(h) EXCEPTION FOR CERTAIN EXISTING ACTIVITIES AND CONTRACTS.—If—

“(1) EXISTING ACCOUNTING PRACTICES.—If, on March 1, 1984, any taxpayer was regularly computing his deduction for mining reclamation activities under a current cost method of accounting (as determined by the Secretary of the Treasury or his delegate), the liability for reclamation activities—

“(A) for land disturbed before the date of the enactment of this Act [July 18, 1984], or

“(B) to which paragraph (2) applies, shall be treated as having been incurred when the land was disturbed.

“(2) FIXED PRICE SUPPLY CONTRACT.—

“(A) IN GENERAL.—In the case of any fixed price supply contract entered into before March 1, 1984, the amendments made by subsection (b) [enacting section 468 of this title] shall not apply to any minerals extracted from such property which are sold pursuant to such contract.

“(B) NO EXTENSION OR RENEGOTIATION.—Subparagraph (A) shall not apply—

“(i) to any extension of any contract beyond the period such contract was in effect on March 1, 1984, or

“(ii) to any renegotiation of, or other change in, the terms and conditions of such contract in effect on March 1, 1984.

“(i) TRANSITIONAL RULE FOR ACCRUED VACATION PAY.—

“(1) IN GENERAL.—In the case of any taxpayer—

“(A) with respect to whom a deduction was allowable (other than under section 463 of the Internal Revenue Code of 1986) for vested accrued vacation pay for the last taxable year ending before the date of the enactment of this Act [July 18, 1984], and

“(B) who elects the application of section 463 of such Code for the first taxable year ending after the date of the enactment of this Act,

then, for purposes of section 463(b) of such Code, the opening balance of the taxpayer with respect to any vested accrued vacation pay shall be determined under section 463(b)(1) of such Code.

“(2) VESTED ACCRUED VACATION PAY.—For purposes of this subsection, the term ‘vested accrued vacation pay’ means any amount allowable under section 162(a) of such Code with respect to vacation pay of employees of the taxpayer (determined without regard to section 463 of such Code).”

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 1901(a)(69) of Pub. L. 94-455 effective for taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

Section 208(b) of Pub. L. 94-455 provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) [amending this section] shall apply to amounts paid after December 31, 1975, in taxable years ending after such date.

“(2) CERTAIN AMOUNTS PAID BEFORE 1977.—The amendment made by subsection (a) [amending this section] shall not apply to amounts paid before January 1, 1977, pursuant to a binding contract or written loan commitment which existed on September 16, 1975 (and at all times thereafter), and which required prepayment of such amounts by the taxpayer.”

EFFECTIVE DATE OF 1964 AMENDMENT

Section 223(b) of Pub. L. 88-272 provided that: “Except as provided in subsections (c) and (d) [set out below]—

“(1) the amendment made by subsection (a)(1) [amending this section] shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954, and

“(2) the amendment made by subsection (a)(2) [amending section 43 of the Internal Revenue Code of

1939] shall apply to taxable years to which the Internal Revenue Code of 1939 applies.”

EFFECTIVE DATE OF 1962 AMENDMENT

Section 3(b) of Pub. L. 87-876 provided that: “The amendment made by subsection (a) [amending this section] shall apply only with respect to taxable years ending after December 31, 1962.”

EFFECTIVE DATE OF 1960 AMENDMENT

Section 6(b) of Pub. L. 86-781 provided that: “The amendment made by subsection (a) [amending this section] shall apply to taxable years ending after December 31, 1960.”

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

TRANSITIONAL RULE FOR CERTAIN AMOUNTS

Section 1807(a)(8) of Pub. L. 99-514 provided that: “For purposes of section 461(h) of the Internal Revenue Code of 1954 [now 1986], economic performance shall be treated as occurring on the date of a payment to an insurance company if—

“(A) such payment was made before November 23, 1985, for indemnification against a tort liability relating to personal injury or death caused by inhalation or ingestion of dust from asbestos-containing insulation products,

“(B) such insurance company is unrelated to taxpayer,

“(C) such payment is not refundable, and

“(D) the taxpayer is not engaged in the mining of asbestos nor is any member of any affiliated group which includes the taxpayer so engaged.”

TRANSITION RULE

Section 1807(c) of Pub. L. 99-514 provided that: “A taxpayer shall be allowed to use the cash receipts and disbursements method of accounting for taxable years ending after January 1, 1982, if such taxpayer—

“(1) is a partnership which was founded in 1936,

“(2) has over 1,000 professional employees,

“(3) used a long-term contract method of accounting for a substantial part of its income from the performance of architectural and engineering services, and

“(4) is headquartered in Chicago, Illinois.”

ELECTION AS TO TRANSFERS IN TAXABLE YEARS
BEGINNING BEFORE JAN. 1, 1964

Section 223(c) of Pub. L. 88-272 provided that:

“(1) The amendments made by subsection (a) [amending this section and section 43 of the Internal Revenue Code of 1939] shall not apply to any transfer of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964, if the taxpayer elects, in the manner provided by regulations prescribed by the Secretary of the Treasury or his delegate, to have this paragraph apply. Such an election—

“(A) must be made within one year after the date of the enactment of this Act [Feb. 26, 1964],

“(B) may not be revoked after the expiration of such one-year period, and

“(C) shall apply to all transfers described in the first sentence of this paragraph (other than transfers described in paragraph (2)).

In the case of any transfer to which this paragraph applies, the deduction shall be allowed only for the taxable year in which the contest with respect to such transfer is settled.

“(2) Paragraph (1) shall not apply to any transfer if the assessment of any deficiency which would result from the application of the election in respect of such transfer is, on the date of the election under paragraph (1), prevented by the operation of any law or rule of law.

“(3) If the taxpayer makes an election under paragraph (1), and if, on the date of such election, the assessment of any deficiency which results from the application of the election in respect of any transfer is not prevented by the operation of any law or rule of law, the period within which assessment of such deficiency may be made shall not expire earlier than 2 years after the date of the enactment of this Act [Feb. 26, 1964].”

CERTAIN OTHER TRANSFERS IN TAXABLE YEARS
BEGINNING BEFORE JAN. 1, 1964

Section 223(d) of Pub. L. 88-272 provided that: “The amendments made by subsection (a) [amending this section and section 43 of the Internal Revenue Code of 1939] shall not apply to any transfer of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964, if—

“(1) no deduction has been allowed in respect of such transfer for any taxable year before the taxable year in which the contest with respect to such transfer is settled, and

“(2) refund or credit of any overpayment which would result from the application of such amendments to such transfer is prevented by the operation of any law or rule of law.

In the case of any transfer to which this subsection applies, the deduction shall be allowed for the taxable year in which the contest with respect to such transfer is settled.”

[§ 462. Repealed. June 15, 1955, ch. 143, § 1(b), 69 Stat. 134]

Section, act Aug. 16, 1954, ch. 736 68A Stat. 153, related to reserves for estimated expenses.

EFFECTIVE DATE OF REPEAL

Repeal effective with respect to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 3 of Act June 15, 1955, set out as an Effective Date of 1955 Amendment note under section 381 of this title.

SAVINGS PROVISION

For provisions concerning increase in tax in any taxable year ending on or before June 15, 1955 by reason of enactment of act June 15, 1955, see section 4 of act June 15, 1955, set out as a note under section 381 of this title.

[§ 463. Repealed. Pub. L. 100-203, title X, § 10201(a), Dec. 22, 1987, 101 Stat. 1330-387]

Section, added Pub. L. 93-625, §4(a), Jan. 3, 1974, 88 Stat. 2109; amended Pub. L. 94-455, title XIX, §1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub. L. 98-369, div. A, title V, §561(a), July 18, 1984, 98 Stat. 901; Pub. L. 99-514, title XI, §1165(a), Oct. 22, 1986, 100 Stat. 2511, related to deduction allowable for accrual basis taxpayers under section 162(a) of this title with respect to vacation pay.

EFFECTIVE DATE OF REPEAL

Repeal applicable to taxable years beginning after Dec. 31, 1987, see section 10201(c)(1) of Pub. L. 100-203, set out as an Effective Date of 1987 Amendment note under section 404 of this title.

CHANGE IN METHOD OF ACCOUNTING REQUIRED BY
PUB. L. 100-203

Pub. L. 100-203, title X, §10201(c)(2), Dec. 22, 1987, 101 Stat. 1330-388, provided that: “In the case of any taxpayer who elected to have section 463 of the Internal

Revenue Code of 1986 apply for such taxpayer's last taxable year beginning before January 1, 1988, and who is required to change his method of accounting by reason of the amendments made by this section [amending sections 404, 419, and 461 of this title, repealing sections 81 and 463 of this title, and enacting provisions set out as a note under section 404 of this title]—

“(A) such change shall be treated as initiated by the taxpayer,

“(B) such change shall be treated as having been made with the consent of the Secretary, and

“(C) the net amount of adjustments required by section 481 of such Code to be taken into account by the taxpayer—

“(i) shall be reduced by the balance in the suspense account under section 463(c) of such Code as of the close of such last taxable year, and

“(ii) shall be taken into account over the 4-taxable year period beginning with the taxable year following such last taxable year as follows:

“In the case of the:	The percentage taken into account is:
1st year	25
2nd year	5
3rd year	35
4th year	35.

Notwithstanding subparagraph (C)(ii), if the period the adjustments are required to be taken into account under section 481 of such Code is less than 4 years, such adjustments shall be taken into account ratably over such shorter period.”

§ 464. Limitations on deductions for certain farming

(a) General rule

In the case of any farming syndicate (as defined in subsection (c)), a deduction (otherwise allowable under this chapter) for amounts paid for feed, seed, fertilizer, or other similar farm supplies shall only be allowed for the taxable year in which such feed, seed, fertilizer, or other supplies are actually used or consumed, or, if later, for the taxable year for which allowable as a deduction (determined without regard to this section).

(b) Certain poultry expenses

In the case of any farming syndicate (as defined in subsection (c))—

(1) the cost of poultry (including egg-laying hens and baby chicks) purchased for use in a trade or business (or both for use in a trade or business and for sale) shall be capitalized and deducted ratably over the lesser of 12 months or their useful life in the trade or business, and

(2) the cost of poultry purchased for sale shall be deducted for the taxable year in which the poultry is sold or otherwise disposed of.

(c) Farming syndicate defined

(1) In general

For purposes of this section, the term “farming syndicate” means—

(A) a partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, if at any time interests in such partnership or enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale, or

(B) a partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs.

(2) Holdings attributable to active management

For purposes of paragraph (1)(B), the following shall be treated as an interest which is not held by a limited partner or a limited entrepreneur:

(A) in the case of any individual who has actively participated (for a period of not less than 5 years) in the management of any trade or business of farming, any interest in a partnership or other enterprise which is attributable to such active participation,

(B) in the case of any individual whose principal residence is on a farm, any partnership or other enterprise engaged in the trade or business of farming such farm,

(C) in the case of any individual who is actively participating in the management of any trade or business of farming or who is an individual who is described in subparagraph (A) or (B), any participation in the further processing of livestock which was raised in such trade or business (or in the trade or business referred to in subparagraph (A) or (B)),

(D) in the case of an individual whose principal business activity involves active participation in the management of a trade or business of farming, any interest in any other trade or business of farming, and,

(E) any interest held by a member of the family (or a spouse of any such member) or a grandparent of an individual described in subparagraph (A), (B), (C), or (D) if the interest in the partnership or the enterprise is attributable to the active participation of the individual described in subparagraph (A), (B), (C), or (D).

For purposes of subparagraph (A), where one farm is substituted for or added to another farm, both farms shall be treated as one farm. For purposes of subparagraph (E), the term “family” has the meaning given to such term by section 267(c)(4).

(d) Exception

Subsection (a) shall not apply to any amount paid for supplies which are on hand at the close of the taxable year on account of fire, storm, or other casualty, or on account of disease or drought.

(e) Definitions

For purposes of this section—

(1) Farming

The term “farming” means the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals. For purposes of the preceding sentence, trees (other than trees bearing fruit or nuts) shall not be treated as an agricultural or horticultural commodity.

(2) Limited entrepreneur

The term “limited entrepreneur” means a person who—

- (A) has an interest in an enterprise other than as a limited partner, and
- (B) does not actively participate in the management of such enterprise.

(f) Subsections (a) and (b) to apply to certain persons prepaying 50 percent or more of certain farming expenses**(1) In general**

In the case of a taxpayer to whom this subsection applies, subsections (a) and (b) shall apply to the excess prepaid farm supplies of such taxpayer in the same manner as if such taxpayer were a farming syndicate.

(2) Taxpayer to whom subsection applies

This subsection applies to any taxpayer for any taxable year if such taxpayer—

- (A) does not use an accrual method of accounting,
- (B) has excess prepaid farm supplies for the taxable year, and
- (C) is not a qualified farm-related taxpayer.

(3) Qualified farm-related taxpayer**(A) In general**

For purposes of this subsection, the term “qualified farm-related taxpayer” means any farm-related taxpayer if—

- (i)(I) the aggregate prepaid farm supplies for the 3 taxable years preceding the taxable year are less than 50 percent of,
- (II) the aggregate deductible farming expenses (other than prepaid farm supplies) for such 3 taxable years, or
- (ii) the taxpayer has excess prepaid farm supplies for the taxable year by reason of any change in business operation directly attributable to extraordinary circumstances.

(B) Farm-related taxpayer

For purposes of this paragraph, the term “farm-related taxpayer” means any taxpayer—

- (i) whose principal residence (within the meaning of section 121) is on a farm,
- (ii) who has a principal occupation of farming, or
- (iii) who is a member of the family (within the meaning of subsection (c)(2)(E)) of a taxpayer described in clause (i) or (ii).

(4) Definitions

For purposes of this subsection—

(A) Excess prepaid farm supplies

The term “excess prepaid farm supplies” means the prepaid farm supplies for the taxable year to the extent the amount of such supplies exceeds 50 percent of the deductible farming expenses for the taxable year (other than prepaid farm supplies).

(B) Prepaid farm supplies

The term “prepaid farm supplies” means any amounts which are described in sub-

section (a) or (b) and would be allowable for a subsequent taxable year under the rules of subsections (a) and (b).

(C) Deductible farming expenses

The term “deductible farming expenses” means any amount allowable as a deduction under this chapter (including any amount allowable as a deduction for depreciation or amortization) which is properly allocable to the trade or business of farming.

(g) Termination

Except as provided in subsection (f), subsections (a) and (b) shall not apply to any taxable year beginning after December 31, 1986.

(Added Pub. L. 94-455, title II, §207(a)(1), Oct. 4, 1976, 90 Stat. 1536; amended Pub. L. 95-600, title VII, §701(l)(3), Nov. 6, 1978, 92 Stat. 2907; Pub. L. 97-354, §5(a)(30), Oct. 19, 1982, 96 Stat. 1695; Pub. L. 99-514, title IV, §404(a), (b)(1), title VIII, §803(b)(8), Oct. 22, 1986, 100 Stat. 2223, 2224, 2356; Pub. L. 100-647, title I, §1008(a)(4), Nov. 10, 1988, 102 Stat. 3437; Pub. L. 105-34, title III, §312(d)(1), Aug. 5, 1997, 111 Stat. 839.)

AMENDMENTS

1997—Subsec. (f)(3)(B)(i). Pub. L. 105-34 substituted “section 121” for “section 1034”.

1988—Subsec. (g). Pub. L. 100-647 added subsec. (g).

1986—Pub. L. 99-514, §404(b)(1), substituted “for certain farming” for “in case of farming syndicates” in section catchline.

Subsec. (d). Pub. L. 99-514, §803(b)(8), substituted “Exception” for “Exceptions” as heading and amended text generally. Prior to amendment, text read as follows: “Subsection (a) shall not apply to—

“(1) any amount paid for supplies which are on hand at the close of the taxable year on account of fire, storm, flood, or other casualty or on account of disease or drought, or

“(2) any amount required to be charged to capital account under section 278.”

Subsec. (f). Pub. L. 99-514, §404(a), added subsec. (f).

1982—Subsec. (c)(1)(A), (B). Pub. L. 97-354 substituted “an S corporation” for “an electing small business corporation (as defined in section 1371(b))”.

1978—Subsec. (c)(2). Pub. L. 95-600 substituted in subpar. (E) “(or a spouse of any such member)” for “(with the meaning of section 267(c)(4))” and provided that for purposes of subpar. (E) the term “family” has the meaning given to such term by section 267(c)(4).

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to sales and exchanges after May 6, 1997, with certain exceptions, see section 312(d) of Pub. L. 105-34, set out as a note under section 121 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

If any interest costs incurred after Dec. 31, 1986, are attributable to costs incurred before Jan. 1, 1987, the amendment by section 803(b)(8) of Pub. L. 99-514 is applicable to such interest costs only to the extent such interest costs are attributable to costs which were required to be capitalized under section 263 of the Internal Revenue Code of 1954 and which would have been taken into account in applying section 189 of the Internal Revenue Code of 1954 (as in effect before its repeal

by section 803 of Pub. L. 99-514) or, if applicable, section 266 of such Code, see section 7831(d)(2) of Pub. L. 101-239, set out as an Effective Date note under section 263A of this title.

Section 404(c) of Pub. L. 99-514 provided that: “The amendments made by this section [amending this section] shall apply to amounts paid or incurred after March 1, 1986, in taxable years beginning after such date.”

Amendment by section 803(b)(8) of Pub. L. 99-514 applicable to costs incurred after Dec. 31, 1986, in taxable years ending after such date, except as otherwise provided, see section 803(d) of Pub. L. 99-514, set out as an Effective Date note under section 263A of this title.

EFFECTIVE DATE OF 1982 AMENDMENT

Amendment by Pub. L. 97-354 applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as an Effective Date note under section 1361 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Amendment by Pub. L. 95-600 effective as if included in this section or section 447 of this title at the time of their enactment, Oct. 4, 1976, see section 701(t)(4) of Pub. L. 95-600, set out as a note under section 447 of this title.

EFFECTIVE DATE

Section 207(a)(3) of Pub. L. 94-455 provided that: “(A) **IN GENERAL.**—Except as provided in subparagraph (B), the amendments made by this subsection [enacting this section] shall apply to taxable years beginning after December 31, 1975.

“(B) **TRANSITIONAL RULE.**—In the case of a farming syndicate in existence on December 31, 1975, and for which there was no change of membership throughout its taxable year beginning in 1976, the amendments made by this subsection shall apply to taxable years beginning after December 31, 1976.”

§ 465. Deductions limited to amount at risk

(a) Limitation to amount at risk

(1) In general

In the case of—

(A) an individual, and

(B) a C corporation with respect to which the stock ownership requirement of paragraph (2) of section 542(a) is met,

engaged in an activity to which this section applies, any loss from such activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is at risk (within the meaning of subsection (b)) for such activity at the close of the taxable year.

(2) Deduction in succeeding year

Any loss from an activity to which this section applies not allowed under this section for the taxable year shall be treated as a deduction allocable to such activity in the first succeeding taxable year.

(3) Special rules for applying paragraph (1)(B)

For purposes of paragraph (1)(B)—

(A) section 544(a)(2) shall be applied as if such section did not contain the phrase “or by or for his partner”; and

(B) sections 544(a)(4)(A) and 544(b)(1) shall be applied by substituting “the corporation meet the stock ownership requirements of section 542(a)(2)” for “the corporation a personal holding company”.

(b) Amounts considered at risk

(1) In general

For purposes of this section, a taxpayer shall be considered at risk for an activity with respect to amounts including—

(A) the amount of money and the adjusted basis of other property contributed by the taxpayer to the activity, and

(B) amounts borrowed with respect to such activity (as determined under paragraph (2)).

(2) Borrowed amounts

For purposes of this section, a taxpayer shall be considered at risk with respect to amounts borrowed for use in an activity to the extent that he—

(A) is personally liable for the repayment of such amounts, or

(B) has pledged property, other than property used in such activity, as security for such borrowed amount (to the extent of the net fair market value of the taxpayer’s interest in such property).

No property shall be taken into account as security if such property is directly or indirectly financed by indebtedness which is secured by property described in paragraph (1).

(3) Certain borrowed amounts excluded

(A) In general

Except to the extent provided in regulations, for purposes of paragraph (1)(B), amounts borrowed shall not be considered to be at risk with respect to an activity if such amounts are borrowed from any person who has an interest in such activity or from a related person to a person (other than the taxpayer) having such an interest.

(B) Exceptions

(i) Interest as creditor

Subparagraph (A) shall not apply to an interest as a creditor in the activity.

(ii) Interest as shareholder with respect to amounts borrowed by corporation

In the case of amounts borrowed by a corporation from a shareholder, subparagraph (A) shall not apply to an interest as a shareholder.

(C) Related person

For purposes of this subsection, a person (hereinafter in this paragraph referred to as the “related person”) is related to any person if—

(i) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1), or

(ii) the related person and such person are engaged in trades or business under common control (within the meaning of subsections (a) and (b) of section 52).

For purposes of clause (i), in applying section 267(b) or 707(b)(1), “10 percent” shall be substituted for “50 percent”.

(4) Exception

Notwithstanding any other provision of this section, a taxpayer shall not be considered at risk with respect to amounts protected

against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements.

(5) Amounts at risk in subsequent years

If in any taxable year the taxpayer has a loss from an activity to which subsection (a) applies, the amount with respect to which a taxpayer is considered to be at risk (within the meaning of subsection (b)) in subsequent taxable years with respect to that activity shall be reduced by that portion of the loss which (after the application of subsection (a)) is allowable as a deduction.

(6) Qualified nonrecourse financing treated as amount at risk

For purposes of this section—

(A) In general

Notwithstanding any other provision of this subsection, in the case of an activity of holding real property, a taxpayer shall be considered at risk with respect to the taxpayer's share of any qualified nonrecourse financing which is secured by real property used in such activity.

(B) Qualified nonrecourse financing

For purposes of this paragraph, the term "qualified nonrecourse financing" means any financing—

- (i) which is borrowed by the taxpayer with respect to the activity of holding real property,
- (ii) which is borrowed by the taxpayer from a qualified person or represents a loan from any Federal, State, or local government or instrumentality thereof, or is guaranteed by any Federal, State, or local government,
- (iii) except to the extent provided in regulations, with respect to which no person is personally liable for repayment, and
- (iv) which is not convertible debt.

(C) Special rule for partnerships

In the case of a partnership, a partner's share of any qualified nonrecourse financing of such partnership shall be determined on the basis of the partner's share of liabilities of such partnership incurred in connection with such financing (within the meaning of section 752).

(D) Qualified person defined

For purposes of this paragraph—

(i) In general

The term "qualified person" has the meaning given such term by section 49(a)(1)(D)(iv).

(ii) Certain commercially reasonable financing from related persons

For purposes of clause (i), section 49(a)(1)(D)(iv) shall be applied without regard to subclause (I) thereof (relating to financing from related persons) if the financing from the related person is commercially reasonable and on substantially the same terms as loans involving unrelated persons.

(E) Activity of holding real property

For purposes of this paragraph—

(i) Incidental personal property and services

The activity of holding real property includes the holding of personal property and the providing of services which are incidental to making real property available as living accommodations.

(ii) Mineral property

The activity of holding real property shall not include the holding of mineral property.

(c) Activities to which section applies

(1) Types of activities

This section applies to any taxpayer engaged in the activity of—

- (A) holding, producing, or distributing motion picture films or video tapes,
- (B) farming (as defined in section 464(e)),
- (C) leasing any section 1245 property (as defined in section 1245(a)(3)),
- (D) exploring for, or exploiting, oil and gas resources as a trade or business or for the production of income, or
- (E) exploring for, or exploiting, geothermal deposits (as defined in section 613(e)(2)).

(2) Separate activities

For purposes of this section—

(A) In general

Except as provided in subparagraph (B), a taxpayer's activity with respect to each—

- (i) film or video tape,
- (ii) section 1245 property which is leased or held for leasing,
- (iii) farm,
- (iv) oil and gas property (as defined under section 614), or
- (v) geothermal property (as defined under section 614),

shall be treated as a separate activity.

(B) Aggregation rules

(i) Special rule for leases of section 1245 property by partnerships or S corporations

In the case of any partnership or S corporation, all activities with respect to section 1245 properties which—

- (I) are leased or held for lease, and
- (II) are placed in service in any taxable year of the partnership or S corporation,

shall be treated as a single activity.

(ii) Other aggregation rules

Rules similar to the rules of subparagraphs (B) and (C) of paragraph (3) shall apply for purposes of this paragraph.

(3) Extension to other activities

(A) In general

In the case of taxable years beginning after December 31, 1978, this section also applies to each activity—

- (i) engaged in by the taxpayer in carrying on a trade or business or for the production of income, and
- (ii) which is not described in paragraph (1).

(B) Aggregation of activities where taxpayer actively participates in management of trade or business

Except as provided in subparagraph (C), for purposes of this section, activities described in subparagraph (A) which constitute a trade or business shall be treated as one activity if—

- (i) the taxpayer actively participates in the management of such trade or business, or
- (ii) such trade or business is carried on by a partnership or an S corporation and 65 percent or more of the losses for the taxable year is allocable to persons who actively participate in the management of the trade or business.

(C) Aggregation or separation of activities under regulations

The Secretary shall prescribe regulations under which activities described in subparagraph (A) shall be aggregated or treated as separate activities.

(D) Application of subsection (b)(3)

In the case of an activity described in subparagraph (A), subsection (b)(3) shall apply only to the extent provided in regulations prescribed by the Secretary.

(4) Exclusion for certain equipment leasing by closely-held corporations

(A) In general

In the case of a corporation described in subsection (a)(1)(B) actively engaged in equipment leasing—

- (i) the activity of equipment leasing shall be treated as a separate activity, and
- (ii) subsection (a) shall not apply to losses from such activity.

(B) 50-percent gross receipts test

For purposes of subparagraph (A), a corporation shall not be considered to be actively engaged in equipment leasing unless 50 percent or more of the gross receipts of the corporation for the taxable year is attributable, under regulations prescribed by the Secretary, to equipment leasing.

(C) Component members of controlled group treated as a single corporation

For purposes of subparagraph (A), the component members of a controlled group of corporations shall be treated as a single corporation.

(5) Waiver of controlled group rule where there is substantial leasing activity

(A) In general

In the case of the component members of a qualified leasing group, paragraph (4) shall be applied—

- (i) by substituting “80 percent” for “50 percent” in subparagraph (B) thereof, and
- (ii) as if paragraph (4) did not include subparagraph (C) thereof.

(B) Qualified leasing group

For purposes of this paragraph, the term “qualified leasing group” means a controlled

group of corporations which, for the taxable year and each of the 2 immediately preceding taxable years, satisfied each of the following 3 requirements:

(i) At least 3 employees

During the entire year, the group had at least 3 full-time employees substantially all of the services of whom were services directly related to the equipment leasing activity of the qualified leasing members.

(ii) At least 5 separate leasing transactions

During the year, the qualified leasing members in the aggregate entered into at least 5 separate equipment leasing transactions.

(iii) At least \$1,000,000 equipment leasing receipts

During the year, the qualified leasing members in the aggregate had at least \$1,000,000 in gross receipts from equipment leasing.

The term “qualified leasing group” does not include any controlled group of corporations to which, without regard to this paragraph, paragraph (4) applies.

(C) Qualified leasing member

For purposes of this paragraph, a corporation shall be treated as a qualified leasing member for the taxable year only if for each of the taxable years referred to in subparagraph (B)—

- (i) it is a component member of the controlled group of corporations, and
- (ii) it meets the requirements of paragraph (4)(B) (as modified by subparagraph (A)(i) of this paragraph).

(6) Definitions relating to paragraphs (4) and (5)

For purposes of paragraphs (4) and (5)—

(A) Equipment leasing

The term “equipment leasing” means—

- (i) the leasing of equipment which is section 1245 property, and
- (ii) the purchasing, servicing, and selling of such equipment.

(B) Leasing of master sound recordings, etc., excluded

The term “equipment leasing” does not include the leasing of master sound recordings, and other similar contractual arrangements with respect to tangible or intangible assets associated with literary, artistic, or musical properties.

(C) Controlled group of corporations; component member

The terms “controlled group of corporations” and “component members” have the same meanings as when used in section 1563. The determination of the taxable years taken into account with respect to any controlled group of corporations shall be made in a manner consistent with the manner set forth in section 1563.

(7) Exclusion of active businesses of qualified C corporations

(A) In general

In the case of a taxpayer which is a qualified C corporation—

(i) each qualifying business carried on by such taxpayer shall be treated as a separate activity, and

(ii) subsection (a) shall not apply to losses from such business.

(B) Qualified C corporation

For purposes of subparagraph (A), the term “qualified C corporation” means any corporation described in subparagraph (B) of subsection (a)(1) which is not—

(i) a personal holding company (as defined in section 542(a)), or

(ii) a personal service corporation (as defined in section 269A(b) but determined by substituting “5 percent” for “10 percent” in section 269A(b)(2)).

(C) Qualifying business

For purposes of this paragraph, the term “qualifying business” means any active business if—

(i) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 1 full-time employee substantially all the services of whom were in the active management of such business,

(ii) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 3 full-time, nonowner employees substantially all of the services of whom were services directly related to such business,

(iii) the amount of the deductions attributable to such business which are allowable to the taxpayer solely by reason of sections 162 and 404 for the taxable year exceeds 15 percent of the gross income from such business for such year, and

(iv) such business is not an excluded business.

(D) Special rules for application of subparagraph (C)

(i) Partnerships in which taxpayer is a qualified corporate partner

In the case of an active business of a partnership, if—

(I) the taxpayer is a qualified corporate partner in the partnership, and

(II) during the entire 12-month period ending on the last day of the partnership’s taxable year, there was at least 1 full-time employee of the partnership (or of a qualified corporate partner) substantially all the services of whom were in the active management of such business,

then the taxpayer’s proportionate share (determined on the basis of its profits interest) of the activities of the partnership in such business shall be treated as activities of the taxpayer (and clause (i) of subparagraph (C) shall not apply in determining whether such business is a qualifying business of the taxpayer).

(ii) Qualified corporate partner

For purposes of clause (i), the term “qualified corporate partner” means any corporation if—

(I) such corporation is a general partner in the partnership,

(II) such corporation has an interest of 10 percent or more in the profits and losses of the partnership, and

(III) such corporation has contributed property to the partnership in an amount not less than the lesser of \$500,000 or 10 percent of the net worth of the corporation.

For purposes of subclause (III), any contribution of property other than money shall be taken into account at its fair market value.

(iii) Deduction for owner employee compensation not taken into account

For purposes of clause (iii) of subparagraph (C), there shall not be taken into account any deduction in respect of compensation for personal services rendered by any employee (other than a non-owner employee) of the taxpayer or any member of such employee’s family (within the meaning of section 318(a)(1)).

(iv) Special rule for banks

For purposes of clause (iii) of subparagraph (C), in the case of a bank (as defined in section 581) or a financial institution to which section 591 applies—

(I) gross income shall be determined without regard to the exclusion of interest from gross income under section 103, and

(II) in addition to the deductions described in such clause, there shall also be taken into account the amount of the deductions which are allowable for amounts paid or credited to the accounts of depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts under section 163 or 591.

(v) Special rule for life insurance companies

(I) In general

Clause (iii) of subparagraph (C) shall not apply to any insurance business of a qualified life insurance company.

(II) Insurance business

For purposes of subclause (I), the term “insurance business” means any business which is not a noninsurance business (within the meaning of section 806(b)(3)).

(III) Qualified life insurance company

For purposes of subclause (I), the term “qualified life insurance company” means any company which would be a life insurance company as defined in section 816 if unearned premiums were not taken into account under subsections (a)(2) and (c)(2) of section 816.

(E) Definitions

For purposes of this paragraph—

(i) Non-owner employee

The term “non-owner employee” means any employee who does not own, at any time during the taxable year, more than 5 percent in value of the outstanding stock of the taxpayer. For purposes of the preceding sentence, section 318 shall apply, except that “5 percent” shall be substituted for “50 percent” in section 318(a)(2)(C).

(ii) Excluded business

The term “excluded business” means—

(I) equipment leasing (as defined in paragraph (6)), and

(II) any business involving the use, exploitation, sale, lease, or other disposition of master sound recordings, motion picture films, video tapes, or tangible or intangible assets associated with literary, artistic, musical, or similar properties.

(iii) Special rules relating to communications industry, etc.**(I) Business not excluded where taxpayer not completely at risk**

A business involving the use, exploitation, sale, lease, or other disposition of property described in subclause (II) of clause (ii) shall not constitute an excluded business by reason of such subclause if the taxpayer is at risk with respect to all amounts paid or incurred (or chargeable to capital account) in such business.

(II) Certain licensed businesses not excluded

For purposes of subclause (II) of clause (ii), the provision of radio, television, cable television, or similar services pursuant to a license or franchise granted by the Federal Communications Commission or any other Federal, State, or local authority shall not constitute an excluded business by reason of such subclause.

(F) Affiliated group treated as 1 taxpayer

For purposes of this paragraph—

(i) In general

Except as provided in subparagraph (G), the component members of an affiliated group of corporations shall be treated as a single taxpayer.

(ii) Affiliated group of corporations

The term “affiliated group of corporations” means an affiliated group (as defined in section 1504(a)) which files or is required to file consolidated income tax returns.

(iii) Component member

The term “component member” means an includible corporation (as defined in section 1504) which is a member of the affiliated group.

(G) Loss of 1 member of affiliated group may not offset income of personal holding company or personal service corporation

Nothing in this paragraph shall permit any loss of a member of an affiliated group to be

used as an offset against the income of any other member of such group which is a personal holding company (as defined in section 542(a)) or a personal service corporation (as defined in section 269A(b) but determined by substituting “5 percent” for “10 percent” in section 269A(b)(2)).

(d) Definition of loss

For purposes of this section, the term “loss” means the excess of the deductions allowable under this chapter for the taxable year (determined without regard to the first sentence of subsection (a)) and allocable to an activity to which this section applies over the income received or accrued by the taxpayer during the taxable year from such activity (determined without regard to subsection (e)(1)(A)).

(e) Recapture of losses where amount at risk is less than zero**(1) In general**

If zero exceeds the amount for which the taxpayer is at risk in any activity at the close of any taxable year—

(A) the taxpayer shall include in his gross income for such taxable year (as income from such activity) an amount equal to such excess, and

(B) an amount equal to the amount so included in gross income shall be treated as a deduction allocable to such activity for the first succeeding taxable year.

(2) Limitation

The excess referred to in paragraph (1) shall not exceed—

(A) the aggregate amount of the reductions required by subsection (b)(5) with respect to the activity by reason of losses for all prior taxable years beginning after December 31, 1978, reduced by

(B) the amounts previously included in gross income with respect to such activity under this subsection.

(Added Pub. L. 94-455, title II, §204(a), Oct. 4, 1976, 90 Stat. 1531; amended Pub. L. 95-600, title II, §§201(a), (c)(1), 202, 203, title VII, §701(k)(2), Nov. 6, 1978, 92 Stat. 2814, 2816, 2906; Pub. L. 95-618, title IV, §402(d), Nov. 9, 1978, 92 Stat. 3202; Pub. L. 96-222, title I, §102(a)(1)(A)-(D), Apr. 1, 1980, 94 Stat. 206; Pub. L. 97-354, §5(a)(31), Oct. 19, 1982, 96 Stat. 1695; Pub. L. 98-369, div. A, title IV, §432(a)-(c), title VII, §721(x)(2), July 18, 1984, 98 Stat. 811-814, 971; Pub. L. 99-514, title II, §201(d)(7)(A), title V, §503(a), (b), title X, §1011(b)(1), Oct. 22, 1986, 100 Stat. 2141, 2243, 2389; Pub. L. 101-508, title XI, §§11813(b)(15), 11815(b)(3), Nov. 5, 1990, 104 Stat. 1388-555, 1388-558; Pub. L. 108-357, title IV, §413(c)(7), Oct. 22, 2004, 118 Stat. 1507.)

AMENDMENTS

2004—Subsec. (c)(7)(B). Pub. L. 108-357 inserted “or” at end of cl. (i), redesignated cl. (iii) as (ii), and struck out former cl. (ii) which read as follows: “a foreign personal holding company (as defined in section 552(a)), or”.

1990—Subsec. (b)(6)(D). Pub. L. 101-508, §11813(b)(15), substituted “49(a)(1)(D)(iv)” for “46(c)(8)(D)(iv)” wherever appearing.

Subsec. (c)(1)(E). Pub. L. 101-508, §11815(b)(3), substituted “section 613(e)(2)” for “section 613(e)(3)”.

1986—Subsec. (b)(3)(C). Pub. L. 99-514, §201(d)(7)(A), struck out “defined” after “person” in heading and amended text generally. Prior to amendment, text read as follows: “For purposes of subparagraph (A), the term ‘related person’ has the meaning given such term by section 168(e)(4).”

Subsec. (b)(6). Pub. L. 99-514, §503(b), added par. (6).

Subsec. (c)(3)(D), (E). Pub. L. 99-514, §503(a), redesignated subpar. (E) as (D) and struck out former subpar. (D) which read as follows: “In the case of activities described in subparagraph (A), the holding of real property (other than mineral property) shall be treated as a separate activity, and subsection (a) shall not apply to losses from such activity. For purposes of the preceding sentence, personal property and services which are incidental to making real property available as living accommodations shall be treated as part of the activity of holding such real property.”

Subsec. (c)(7)(D)(v)(II). Pub. L. 99-514, §1011(b)(1), substituted “section 806(b)(3)” for “section 806(c)(3)”.

1984—Subsec. (a)(1)(B). Pub. L. 98-369, §721(x)(2), substituted “a C corporation” for “a corporation”.

Subsec. (b)(3). Pub. L. 98-369, §432(c), designated existing provisions as subpar. (A), in subpar. (A) as so designated struck out subpar. designations “(A)” and “(B)” and substituted provisions that, except as provided by regulation, amounts borrowed shall not be considered to be at risk if such amounts are borrowed from any person who has an interest in the activity or from a related person to a person (other than the taxpayer) having such an interest for provision that such amounts would not be considered to be at risk if borrowed from a person who had an interest (other than as a creditor) in such activity or who had a relationship to the taxpayer specified in section 267(b) of this title, and added subpars. (B) and (C).

Subsec. (c)(2). Pub. L. 98-369, §432(b), designated existing provisions as subpar. (A), in subpar. (A) as so designated, redesignated former subpars. (A) to (E) as cls. (i) to (v), respectively, struck out provision that a partner’s interest in a partnership or a shareholder’s interest in an S corporation had to be treated as a single activity to the extent that the partnership or the S corporation was engaged in activities described in any subparagraph of this paragraph, and added subpar. (B).

Subsec. (c)(7). Pub. L. 98-369, §432(a), added par. (7).

1982—Subsec. (a)(1). Pub. L. 97-354, §5(a)(31)(A), redesignated subpar. (C) as (B). Former subpar. (B), relating to an electing small business corporation, was struck out.

Subsec. (a)(3). Pub. L. 97-354, §5(a)(31)(B), substituted “paragraph (1)(B)” for “paragraph (1)(C)” in heading and text.

Subsec. (c)(2). Pub. L. 97-354, §5(a)(31)(C), substituted “an S corporation” for “an electing small business corporation” the first place appearing and “the S corporation” for “an electing small business corporation” the second place appearing.

Subsec. (c)(3)(B)(ii). Pub. L. 97-354, §5(a)(31)(D), substituted “an S corporation” for “electing small business corporation (as defined in section 1371(b))”.

Subsec. (c)(4)(A). Pub. L. 97-354, §5(a)(31)(E), substituted “subsection (a)(1)(B)” for “subsection (a)(1)(C)”.

1980—Subsec. (a)(1)(C), (3). Pub. L. 96-222, §102(a)(1)(A), struck out in par. (1)(C) “(determined by reference to the rules contained in section 318 rather than under section 544)” after “of section 542(a)” and added par. (3).

Subsec. (b)(5). Pub. L. 96-222, §102(a)(1)(D)(iii), substituted “to which subsection (a) applies” for “to which this section applies”.

Subsec. (c)(3)(D). Pub. L. 96-222, §102(a)(1)(D)(ii), struck out provisions relating to equipment leasing by closely-held corporations.

Subsec. (c)(4) to (6). Pub. L. 96-222, §102(a)(1)(D)(i), added pars. (4) to (6).

Subsec. (d). Pub. L. 96-222, §102(a)(1)(B), inserted “(determined without regard to subsection (e)(1)(A))” after “from such activity”.

Subsec. (e)(2)(A). Pub. L. 96-222, §102(a)(1)(C), inserted “by reason of losses” after “with respect to the activity”.

1978—Pub. L. 95-600, §201(c)(1), substituted “Deductions limited to amount at risk” for “Deductions limited to amount at risk in case of certain activities” in section catchline.

Subsec. (a). Pub. L. 95-600, §202, redesignated existing provisions as par. (1), substituted provisions relating to limitations with respect to an individual, an electing small business corporation defined under section 1371(b) of this title, and a corporation meeting the stock ownership requirements of section 542(a)(2) of this title and the rules of section 318 of this title, for provisions relating to limitations with respect to a taxpayer other than a corporation which is neither an electing small business corporation defined under section 1371(b) of this title, nor a personal holding company defined under section 542 of this title, and added par. (2).

Subsec. (c)(1)(E). Pub. L. 95-618, §402(d)(1), added subpar. (E).

Subsec. (c)(2)(E). Pub. L. 95-618, §402(d)(2), added subpar. (E).

Subsec. (c)(3). Pub. L. 95-600, §201(a), added par. (3).

Subsec. (d). Pub. L. 95-600, §701(k)(2), substituted “(determined without regard to the first sentence of subsection (a))” for “(determined without regard to this section)”.

Subsec. (e). Pub. L. 95-600, §203, added subsec. (e).

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by section 11813(b)(15) of Pub. L. 101-508 applicable to property placed in service after Dec. 31, 1990, but not applicable to any transition property (as defined in section 49(e) of this title), any property with respect to which qualified progress expenditures were previously taken into account under section 46(d) of this title, and any property described in section 46(b)(2)(C) of this title, as such sections were in effect on Nov. 4, 1990, see section 11813(c) of Pub. L. 101-508, set out as a note under section 45K of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 201(d)(7)(A) of Pub. L. 99-514 applicable to property placed in service after Dec. 31, 1986, in taxable years ending after such date, with exceptions, see sections 203 and 204 of Pub. L. 99-514, set out as a note under section 168 of this title.

Amendment by section 201(d)(7)(A) of Pub. L. 99-514 not applicable to any property placed in service before Jan. 1, 1994, if such property placed in service as part of specified rehabilitations, and not applicable to certain additional rehabilitations, see section 251(d)(2), (3) of Pub. L. 99-514, set out as a note under section 46 of this title.

Section 503(c) of Pub. L. 99-514 provided that:

“(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section [amending this section] shall apply to losses incurred after December 31, 1986, with respect to property placed in service by the taxpayer after December 31, 1986.

“(2) SPECIAL RULE FOR LOSSES OF S CORPORATION, PARTNERSHIP, OR PASS-THRU ENTITY.—In the case of an interest in an S corporation, a partnership, or other pass-thru entity acquired after December 31, 1986, the amendments made by this section shall apply to losses after December 31, 1986, which are attributable to property placed in service by the S corporation, partnership, or pass-thru entity on, before, or after January 1, 1986.

“(3) SPECIAL RULE FOR ATHLETIC STADIUM.—The amendments made by this section shall not apply to any losses incurred by a taxpayer with respect to the holding of a multi-use athletic stadium in Pittsburgh, Pennsylvania, which the taxpayer acquired in a sale for which a letter of understanding was entered into before April 16, 1986.”

Amendment by section 1011(b)(1) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 1011(c)(1) of Pub. L. 99-514, set out as a note under section 453B of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 432(d) of Pub. L. 98-369, as amended by Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 1983; except that any loss from an activity described in section 465(c)(7)(A) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as amended by this section) which (but for the amendments made by this section) would have been treated as a deduction for the taxpayer’s first taxable year beginning after December 31, 1983, under section 465(a)(2) of such Code shall be allowed as a deduction for such first taxable year notwithstanding such amendments.”

Amendment by section 721(x)(2) of Pub. L. 98-369 effective as if included in the Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE OF 1982 AMENDMENT

Amendment by Pub. L. 97-354 applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as an Effective Date note under section 1361 of this title.

EFFECTIVE DATE OF 1980 AMENDMENT

Amendment by Pub. L. 96-222 effective, except as otherwise provided, as if it had been included in the provisions of the Revenue Act of 1978, Pub. L. 95-600, to which such amendment relates, see section 201 of Pub. L. 96-222, set out as a note under section 32 of this title.

EFFECTIVE DATE OF 1978 AMENDMENTS

Amendment by Pub. L. 95-618 applicable with respect to wells commenced on or after Oct. 1, 1978, in taxable years ending on or after such date, see section 402(e) of Pub. L. 95-618, set out as a note under section 263 of this title.

Section 204(a) of Pub. L. 95-600 provided that: “The amendments made by this subtitle [amending this section and section 704 of this title and enacting provisions set out as notes under this section and section 704 of this title] shall apply to taxable years beginning after December 31, 1978.”

Section 701(k)(3) of Pub. L. 95-600 provided that: “The amendments made by this subsection [amending this section and provisions set out below] shall take effect on October 4, 1976.”

EFFECTIVE DATE AND TRANSITIONAL RULES

Section 204(c) of Pub. L. 94-455, as amended by Pub. L. 95-600, title VII, § 701(k)(1), Nov. 6, 1978, 92 Stat. 2906; Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amendments made by this section [enacting this section] shall apply to losses attributable to amounts paid or incurred in taxable years beginning after December 31, 1975. For purposes of this subsection, any amount allowed or allowable for depreciation or amortization for any period shall be treated as an amount paid or incurred in such period.

“(2) SPECIAL TRANSITIONAL RULES FOR MOVIES AND VIDEO TAPES.—

“(A) IN GENERAL.—In the case of any activity described in section 465(c)(1)(A) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], the amendments made by this section shall not apply to—

“(i) deductions for depreciation or amortization with respect to property the principal production of which began before September 11, 1975, and for the purchase of which there was on September 11, 1975, and at all times thereafter a binding contract, and

“(ii) deductions attributable to producing or distributing property the principal production of which began before September 11, 1975.

“(B) EXCEPTION FOR CERTAIN AGREEMENTS WHERE PRINCIPAL PHOTOGRAPHY BEGIN BEFORE 1976.—In the case of any activity described in section 465(c)(1)(A) of the Internal Revenue Code of 1986, the amendments made by this section shall not apply to deductions attributable to the producing of a film the principal photography of which began on or before December 31, 1975, if—

“(i) on September 10, 1975, there was an agreement with the director or a principal motion picture star, or on or before September 10, 1975, there had been expended (or committed to the production) an amount not less than the lower of \$100,000 or 10 percent of the estimated costs of producing the film, and

“(ii) the production takes place in the United States.

Subparagraph (A) shall apply only to taxpayers who held their interests on September 10, 1975. Subparagraph (B) shall apply only to taxpayers who held their interests on December 31, 1975.

“(3) SPECIAL TRANSITIONAL RULES FOR LEASING ACTIVITIES.—

“(A) RULE FOR LEASES OTHER THAN OPERATING LEASES.—In the case of any activity described in section 465(c)(1)(C) of the Internal Revenue Code of 1986, the amendments made by this section shall not apply with respect to—

“(i) leases entered into before January 1, 1976, and

“(ii) leases where the property was ordered by the lessor or lessee before January 1, 1976.

“(B) HOLDING OF INTERESTS FOR PURPOSES OF SUBPARAGRAPH (A).—Subparagraph (A) shall apply only to taxpayers who held their interests in the property on December 31, 1975.

“(C) SPECIAL RULE FOR OPERATING LEASES.—In the case of a lease described in section 46(e)(3)(B) of the Internal Revenue Code of 1986—

“(i) subparagraph (A) shall be applied by substituting ‘May 1, 1976’ for ‘January 1, 1976’ each place it appears therein, and

“(ii) subparagraph (B) shall be applied by substituting ‘April 30, 1976’ for ‘December 31, 1975.’”

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

TRANSITIONAL RULES FOR RECAPTURE PROVISIONS AND LEASING ACTIVITIES

Section 204(b) of Pub. L. 95-600, as amended by Pub. L. 96-222, title I, § 102(a)(1)(E), Apr. 1, 1980, 94 Stat. 208; Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(1) RECAPTURE PROVISIONS.—If the amount for which the taxpayer is at risk in any activity as of the close of the taxpayer’s last taxable year beginning before January 1, 1979, is less than zero, section 465(e)(1) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as added by section 203 of this Act) shall be applied with respect to such activity of the taxpayer by substituting such negative amount for zero.

“(2) SPECIAL TRANSITIONAL RULES FOR LEASING ACTIVITIES.—

“(A) RULE FOR LEASES.—In the case of any activity described in section 465(c)(1)(C) of such Code in which a corporation described in section 465(a)(1)(C) of such Code is engaged, the amendments made by this subtitle [amending sections 465 and 704 of this title and enacting provisions set out as notes under sections 465 and 704 of this title] shall not apply with respect to—

“(i) leases entered into before November 1, 1978, and

“(ii) leases where the property was ordered by the lessor or lessee before November 1, 1978.

“(B) HOLDING OF INTERESTS FOR PURPOSES OF SUB-PARAGRAPH (A).—Subparagraph (A) shall apply only to taxpayers who held their interests in the property on October 31, 1978.”

[§ 466. Repealed. Pub. L. 99-514, title VIII, § 823(a), Oct. 22, 1986, 100 Stat. 2373]

Section, added Pub. L. 95-600, title III, § 373(a), Nov. 6, 1978, 92 Stat. 2863; amended Pub. L. 96-222, title I, § 103(a)(16), Apr. 1, 1980, 94 Stat. 214, related to qualified discount coupons redeemed after close of taxable year.

EFFECTIVE DATE OF REPEAL

Section 823(c) of Pub. L. 99-514 provided:

“(1) IN GENERAL.—The amendments made by this section [amending section 461 of this title and repealing this section] shall apply to taxable years beginning after December 31, 1986.

“(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer who elected to have section 466 of the Internal Revenue Code of 1954 [now 1986] apply for such taxpayer’s last taxable year beginning before January 1, 1987, and is required to change its method of accounting by reason of the amendments made by this section for any taxable year—

“(A) such change shall be treated as initiated by the taxpayer,

“(B) such change shall be treated as having been made with the consent of the Secretary, and

“(C) the net amount of adjustments required by section 481 of the Internal Revenue Code of 1986 to be taken into account by the taxpayer shall—

“(i) be reduced by the balance in the suspense account under section 466(e) of such Code as of the close of such last taxable year, and

“(ii) be taken into account over a period not longer than 4 years.”

§ 467. Certain payments for the use of property or services

(a) Accrual method on present value basis

In the case of the lessor or lessee under any section 467 rental agreement, there shall be taken into account for purposes of this title for any taxable year the sum of—

(1) the amount of the rent which accrues during such taxable year as determined under subsection (b), and

(2) interest for the year on the amounts which were taken into account under this subsection for prior taxable years and which are unpaid.

(b) Accrual of rental payments

(1) Allocation follows agreement

Except as provided in paragraph (2), the determination of the amount of the rent under any section 467 rental agreement which accrues during any taxable year shall be made—

(A) by allocating rents in accordance with the agreement, and

(B) by taking into account any rent to be paid after the close of the period in an

amount determined under regulations which shall be based on present value concepts.

(2) Constant rental accrual in case of certain tax avoidance transactions, etc.

In the case of any section 467 rental agreement to which this paragraph applies, the portion of the rent which accrues during any taxable year shall be that portion of the constant rental amount with respect to such agreement which is allocable to such taxable year.

(3) Agreements to which paragraph (2) applies

Paragraph (2) applies to any rental payment agreement if—

(A) such agreement is a disqualified leaseback or long-term agreement, or

(B) such agreement does not provide for the allocation referred to in paragraph (1)(A).

(4) Disqualified leaseback or long-term agreement

For purposes of this subsection, the term “disqualified leaseback or long-term agreement” means any section 467 rental agreement if—

(A) such agreement is part of a leaseback transaction or such agreement is for a term in excess of 75 percent of the statutory recovery period for the property, and

(B) a principal purpose for providing increasing rents under the agreement is the avoidance of tax imposed by this subtitle.

(5) Exceptions to disqualification in certain cases

The Secretary shall prescribe regulations setting forth circumstances under which agreements will not be treated as disqualified leaseback or long-term agreements, including circumstances relating to—

(A) changes in amounts paid determined by reference to price indices,

(B) rents based on a fixed percentage of lessee receipts or similar amounts,

(C) reasonable rent holidays, or

(D) changes in amounts paid to unrelated 3rd parties.

(c) Recapture of prior understated inclusions under leaseback or long-term agreements

(1) In general

If—

(A) the lessor under any section 467 rental agreement disposes of any property subject to such agreement during the term of such agreement, and

(B) such agreement is a leaseback or long-term agreement to which paragraph (2) of subsection (b) did not apply,

the recapture amount shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Recapture amount

For purposes of paragraph (1), the term “recapture amount” means the lesser of—

(A) the prior understated inclusions, or

(B) the excess of the amount realized (or in the case of a disposition other than a sale,

exchange, or involuntary conversion, the fair market value of the property) over the adjusted basis of such property.

The amount determined under subparagraph (B) shall be reduced by the amount of any gain treated as ordinary income on the disposition under any other provision of this subtitle.

(3) Prior understated inclusions

For purposes of this subsection, the term “prior understated inclusion” means the excess (if any) of—

(A) the amount which would have been taken into account by the lessor under subsection (a) for periods before the disposition if subsection (b)(2) had applied to the agreement, over

(B) the amount taken into account under subsection (a) by the lessor for periods before the disposition.

(4) Leaseback or long-term agreement

For purposes of this subsection, the term “leaseback or long-term agreement” means any agreement described in subsection (b)(4)(A).

(5) Special rules

Under regulations prescribed by the Secretary—

(A) exceptions similar to the exceptions applicable under section 1245 or 1250 (whichever is appropriate) shall apply for purposes of this subsection,

(B) any transferee in a disposition excepted by reason of subparagraph (A) who has a transferred basis in the property shall be treated in the same manner as the transferor, and

(C) for purposes of sections 170(e) and 751(c), amounts treated as ordinary income under this section shall be treated in the same manner as amounts treated as ordinary income under section 1245 or 1250.

(d) Section 467 rental agreements

(1) In general

Except as otherwise provided in this subsection, the term “section 467 rental agreements” means any rental agreement for the use of tangible property under which—

(A) there is at least one amount allocable to the use of property during a calendar year which is to be paid after the close of the calendar year following the calendar year in which such use occurs, or

(B) there are increases in the amount to be paid as rent under the agreement.

(2) Section not to apply to agreements involving payments of \$250,000 or less

This section shall not apply to any amount to be paid for the use of property if the sum of the following amounts does not exceed \$250,000—

(A) the aggregate amount of payments received as consideration for such use of property, and

(B) the aggregate value of any other consideration to be received for such use of property.

For purposes of the preceding sentence, rules similar to the rules of clauses (ii) and (iii) of section 1274(c)(4)(C) shall apply.

(e) Definitions

For purposes of this section—

(1) Constant rental amount

The term “constant rental amount” means, with respect to any section 467 rental agreement, the amount which, if paid as of the close of each lease period under the agreement, would result in an aggregate present value equal to the present value of the aggregate payments required under the agreement.

(2) Leaseback transaction

A transaction is a leaseback transaction if it involves a leaseback to any person who had an interest in such property at any time within 2 years before such leaseback (or to a related person).

(3) Statutory recovery period

(A) In general

In the case of:	The statutory recovery period is:
3-year property	3 years
5-year property	5 years
7-year property	7 years
10-year property	10 years
15-year and 20-year property	15 years
Residential rental property and nonresidential real property	19 years
Any railroad grading or tunnel bore	50 years.

(B) Special rule for property not depreciable under section 168

In the case of property to which section 168 does not apply, subparagraph (A) shall be applied as if section 168 applies to such property.

(4) Discount and interest rate

For purposes of computing present value and interest under subsection (a)(2), the rate used shall be equal to 110 percent of the applicable Federal rate determined under section 1274(d) (compounded semiannually) which is in effect at the time the agreement is entered into with respect to debt instruments having a maturity equal to the term of the agreement.

(5) Related person

The term “related person” has the meaning given to such term by section 465(b)(3)(C).

(6) Certain options of lessee to renew not taken into account

Except as provided in regulations prescribed by the Secretary, there shall not be taken into account in computing the term of any agreement for purposes of this section any extension which is solely at the option of the lessee.

(f) Comparable rules where agreement for decreasing payments

Under regulations prescribed by the Secretary, rules comparable to the rules of this section shall also apply in the case of any agreement where the amount paid under the agreement for the use of property decreases during the term of the agreement.

(g) Comparable rules for services

Under regulations prescribed by the Secretary, rules comparable to the rules of subsection (a)(2) shall also apply in the case of payments for serv-

ices which meet requirements comparable to the requirements of subsection (d). The preceding sentence shall not apply to any amount to which section 404 or 404A (or any other provision specified in regulations) applies.

(h) Regulations

The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations providing for the application of this section in the case of contingent payments.

(Added Pub. L. 98-369, div. A, title I, §92(a), July 18, 1984, 98 Stat. 609; amended Pub. L. 99-514, title II, §201(d)(8), title V, §511(d)(2)(A), title VI, §631(e)(10), title XVIII, §§1807(b), 1879(f)(1), Oct. 22, 1986, 100 Stat. 2141, 2248, 2274, 2816, 2906; Pub. L. 100-647, title I, §§1002(i)(2)(H), 1005(c)(10), Nov. 10, 1988, 102 Stat. 3371, 3392; Pub. L. 108-27, title III, §302(e)(4)(B)(ii), May 28, 2003, 117 Stat. 764.)

AMENDMENT OF SECTION

For termination of amendment by section 303 of Pub. L. 108-27, see Effective and Termination Dates of 2003 Amendment note below.

AMENDMENTS

2003—Subsec. (c)(5)(C). Pub. L. 108-27, §§302(e)(4)(B)(ii), 303, temporarily struck out “, 341(e)(12),” after “170(e)”. See Effective and Termination Dates of 2003 Amendment note below.

1988—Subsec. (c)(5)(C). Pub. L. 100-647, §1005(c)(10), made technical correction to directory language of Pub. L. 99-514, §511(d)(2)(A). See 1986 Amendment note below.

Subsec. (e)(3)(A). Pub. L. 100-647, §1002(i)(2)(H), at end of table inserted item relating to any railroad grading or tunnel bore.

1986—Subsec. (b)(4)(A). Pub. L. 99-514, §1807(b)(2)(A), substituted “statutory recovery period” for “statutory recover period”.

Subsec. (c)(4). Pub. L. 99-514, §1807(b)(2)(B), substituted “subsection (b)(4)(A)” for “subsection (b)(3)(A)”.

Subsec. (c)(5)(C). Pub. L. 99-514, §631(e)(10), struck out “453B(d)(2),” after “341(e)(12),”.

Pub. L. 99-514, §511(d)(2)(A), as amended by Pub. L. 100-647, §1005(c)(10), struck out “163(d),” after “sections”.

Subsec. (d)(2). Pub. L. 99-514, §1807(b)(2)(C), substituted “section 1274(c)(4)(C)” for “section 1274(c)(2)(C)”.

Subsec. (e)(3)(A). Pub. L. 99-514, §201(d)(8)(A), in amending subpar. (A) generally, included in table 7-year property, 15-year and 20-year property, and residential rental property and nonresidential real property having recovery periods of 7, 15, and 19 years, respectively, and struck out from table low-income housing, 15-year public utility property, and 19-year real property having recovery periods of 15, 15, and 19 years, respectively.

Pub. L. 99-514, §1879(f)(1), substituted “19-year real property” and “19 years” for “18-year real property” and “18 years”, respectively.

Subsec. (e)(3)(B). Pub. L. 99-514, §201(d)(8)(A), in amending subpar. (B) generally, substituted in heading “not depreciable under section 168” for “which is not recovery property” and in text “In the case of property to which section 168 does not apply, subparagraph (A) shall be applied as if section 168 applies to such property.” for “In the case of any property, which is not recovery property, subparagraph (A) shall be applied as if such property were recovery property.”

Subsec. (e)(5). Pub. L. 99-514, §201(d)(8)(B), substituted “section 465(b)(3)(C)” for “section 168(e)(4)(D)”.

Pub. L. 99-514, §1807(b)(2)(D), substituted “section 168(e)(4)(D)” for “section 168(d)(4)(D)”.

Subsec. (g). Pub. L. 99-514, §1807(b)(1), inserted at end “The preceding sentence shall not apply to any amount to which section 404 or 404A (or any other provision specified in regulations) applies.”

EFFECTIVE AND TERMINATION DATES OF 2003 AMENDMENT

Amendment by Pub. L. 108-27 applicable, except as otherwise provided, to taxable years beginning after Dec. 31, 2002, see section 302(f) of Pub. L. 108-27, set out as a note under section 1 of this title.

Amendment by Pub. L. 108-27 inapplicable to taxable years beginning after Dec. 31, 2010, and the Internal Revenue Code of 1986 to be applied and administered to such years as if such amendment had never been enacted, see section 303 of Pub. L. 108-27, as amended, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 201(d)(8) of Pub. L. 99-514 applicable to property placed in service after Dec. 31, 1986, in taxable years ending after such date, with exceptions, see sections 203 and 204 of Pub. L. 99-514, set out as a note under section 168 of this title.

Amendment by section 201(d)(8) of Pub. L. 99-514 not applicable to any property placed in service before Jan. 1, 1994, if such property placed in service as part of specified rehabilitations, and not applicable to certain additional rehabilitations, see section 251(d)(2), (3) of Pub. L. 99-514, set out as a note under section 46 of this title.

Amendment by section 511(d)(2)(A) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 511(e) of Pub. L. 99-514, set out as a note under section 163 of this title.

Amendment by section 631(e)(10) of Pub. L. 99-514 applicable to any distribution in complete liquidation, and any sale or exchange, made by a corporation after July 31, 1986, unless such corporation is completely liquidated before Jan. 1, 1987, any transaction described in section 338 of this title for which the acquisition date occurs after Dec. 31, 1986, and any distribution, not in complete liquidation, made after Dec. 31, 1986, with exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, set out as an Effective Date note under section 336 of this title.

Amendment by section 1807(b) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

Section 1879(f)(2) of Pub. L. 99-514 provided that: “The amendments made by paragraph (1) [amending this section] shall take effect as if included in the amendments made by section 103 of Public Law 99-121.”

EFFECTIVE DATE

Section 92(c) of Pub. L. 98-369, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section [enacting this section] shall apply with respect to agreements entered into after June 8, 1984.

“(2) EXCEPTIONS.—The amendments made by this section shall not apply—

“(A) to any agreement entered into pursuant to a written agreement which was binding on June 8, 1984, and at all times thereafter,

“(B) subject to the provisions of paragraph (3), to any agreement to lease property if—

“(i) there was in effect a firm plan, evidenced by a board of directors’ resolution, memorandum of

agreement, or letter of intent on March 15, 1984, to enter into such an agreement, and

“(ii) construction of the property was commenced (but such property was not placed in service) on or before March 15, 1984, and

“(C) to any agreement to lease property if—

“(i) the lessee of such property adopted a firm plan to lease the property, evidenced by a resolution of the Finance Committee of the Board of Directors of such lessee, on February 10, 1984,

“(ii) the sum of the present values of the rents payable by the lessee under the lease at the inception thereof equals at least \$91,223,034, assuming for purposes of this clause—

“(I) the annual discount rate is 12.6 percent,

“(II) the initial payment of rent occurs 12 months after the commencement of the lease, and

“(III) subsequent payments of rents occur on the anniversary date of the initial payment, and

“(iii) during—

“(I) the first 5 years of the lease, at least 9 percent of the rents payable by the lessee under the agreement are paid, and

“(II) the second 5 years of the lease, at least 16.25 percent of the rents payable by the lessee under the agreement are paid.

Paragraph (3)(B)(i)(II) shall apply for purposes of clauses (i) and (iii) of subparagraph (C), as if, as of the beginning of the last stage, the separate agreements were treated as 1 single agreement relating to all property covered by the agreements, including any property placed in service before the property to which the agreement for the last stage relates. If the lessor under the agreement described in subparagraph (C) leases the property from another person, this exception shall also apply to any agreement between the lessor and such person which is integrally related to, and entered into at the same time as, such agreement, and which calls for comparable payments of rent over the primary term of the agreement.

“(3) SCHEDULE OF DEEMED RENTAL PAYMENTS.—

“(A) IN GENERAL.—In any case to which paragraph (2)(B) applies, for purposes of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], the lessor shall be treated as having received or accrued (and the lessee shall be treated as having paid or incurred) rents equal to the greater of—

“(i) the amount of rents actually paid under the agreement during the taxable year, or

“(ii) the amount of rents determined in accordance with the schedule under subparagraph (B) for such taxable year.

“(B) SCHEDULE.—

“(i) IN GENERAL.—The schedule under this subparagraph is as follows:

“Portion of lease term:	Cumulative percentage of total rent deemed paid:
1st 1/2	10
2nd 1/2	25
3rd 1/2	45
4th 1/2	70
Last 1/2	100.

“(ii) OPERATING RULES.—For purposes of this schedule—

“(I) the rent allocable to each taxable year within any portion of a lease term described in such schedule shall be a level pro rata amount properly allocable to such taxable year, and

“(II) any agreement relating to property which is to be placed in service in 2 or more stages shall be treated as 2 or more separate agreements.

“(C) PARAGRAPH NOT TO APPLY.—This paragraph shall not apply to any agreement if the sum of the present values of all payments under the agreement is greater than the sum of the present value of all the payments deemed to be paid or received under the schedule under subparagraph (B). For purposes of

computing any present value under this subparagraph, the annual discount rate shall be equal to 12 percent, compounded semiannually.”

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101–1147 and 1171–1177] or title XVIII [§§1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

§ 468. Special rules for mining and solid waste reclamation and closing costs

(a) Establishment of reserves for reclamation and closing costs

(1) Allowance of deduction

If a taxpayer elects the application of this section with respect to any mining or solid waste disposal property, the amount of any deduction for qualified reclamation or closing costs for any taxable year to which such election applies shall be equal to the current reclamation or closing costs allocable to—

(A) in the case of qualified reclamation costs, the portion of the reserve property which was disturbed during such taxable year, and

(B) in the case of qualified closing costs, the production from the reserve property during such taxable year.

(2) Opening balance and adjustments to reserve

(A) Opening balance

The opening balance of any reserve for its first taxable year shall be zero.

(B) Increase for interest

A reserve shall be increased each taxable year by an amount equal to the amount of interest which would have been earned during such taxable year on the opening balance of such reserve for such taxable year if such interest were computed—

(i) at the Federal short-term rate or rates (determined under section 1274) in effect, and

(ii) by compounding semiannually.

(C) Reserve to be charged for amounts paid

Any amount paid by the taxpayer during any taxable year for qualified reclamation or closing costs allocable to portions of the reserve property for which the election under paragraph (1) was in effect shall be charged to the appropriate reserve as of the close of the taxable year.

(D) Reserve increased by amount deducted

A reserve shall be increased each taxable year by the amount allowable as a deduction under paragraph (1) for such taxable year which is allocable to such reserve.

(3) Allowance of deduction for excess amounts paid

There shall be allowed as a deduction for any taxable year the excess of—

(A) the amounts described in paragraph (2)(C) paid during such taxable year, over

(B) the closing balance of the reserve for such taxable year (determined without regard to paragraph (2)(C)).

(4) Limitation on balance as of the close of any taxable year

(A) Reclamation reserves

In the case of any reserve for qualified reclamation costs, there shall be included in gross income for any taxable year an amount equal to the excess of—

- (i) the closing balance of the reserve for such taxable year, over
- (ii) the current reclamation costs of the taxpayer for all portions of the reserve property disturbed during any taxable year to which the election under paragraph (1) applies.

(B) Closing costs reserves

In the case of any reserve for qualified closing costs, there shall be included in gross income for any taxable year an amount equal to the excess of—

- (i) the closing balance of the reserve for such taxable year, over
- (ii) the current closing cost of the taxpayer with respect to the reserve property, determined as if all production with respect to the reserve property for any taxable year to which the election under paragraph (1) applies had occurred in such taxable year.

(C) Order of application

This paragraph shall be applied after all adjustments to the reserve have been made for the taxable year.

(5) Income inclusions on completion or disposition

Proper inclusion in income shall be made upon—

- (A) the revocation of an election under paragraph (1), or
- (B) completion of the closing, or disposition of any portion, of a reserve property.

(b) Allocation for property where election not in effect for all taxable years

If the election under subsection (a)(1) is not in effect for 1 or more taxable years in which the reserved property is disturbed (or production occurs), items with respect to the reserve property shall be allocated to the reserve in such manner as the Secretary may prescribe by regulations.

(c) Revocation of election; separate reserves

(1) Revocation of election

(A) In general

The taxpayer may revoke an election under subsection (a)(1) with respect to any property. Such revocation, once made, shall be irrevocable.

(B) Time and manner of revocation

Any revocation under subparagraph (A) shall be made at such time and in such manner as the Secretary may prescribe.

(2) Separate reserves required

If a taxpayer makes an election under subsection (a)(1), the taxpayer shall establish

with respect to the property for which the election was made—

- (A) a separate reserve for qualified reclamation costs, and
- (B) a separate reserve for qualified closing costs.

(d) Definitions and special rules relating to reclamation and closing costs

For purposes of this section—

(1) Current reclamation and closing costs

(A) Current reclamation costs

The term “current reclamation costs” means the amount which the taxpayer would be required to pay for qualified reclamation costs if the reclamation activities were performed currently.

(B) Current closing costs

(i) In general

The term “current closing costs” means the amount which the taxpayer would be required to pay for qualified closing costs if the closing activities were performed currently.

(ii) Costs computed on unit-of-production or capacity method

Estimated closing costs shall—

- (I) in the case of the closing of any mine site, be computed on the unit-of-production method of accounting, and
- (II) in the case of the closing of any solid waste disposal site, be computed on the unit-of-capacity method.

(2) Qualified reclamation or closing costs

The term “qualified reclamation or closing costs” means any of the following expenses:

(A) Mining reclamation and closing costs

Any expenses incurred for any land reclamation or closing activity which is conducted in accordance with a reclamation plan (including an amendment or modification thereof)—

(i) which—

(I) is submitted pursuant to the provisions of section 511 or 528 of the Surface Mining Control and Reclamation Act of 1977 (as in effect on January 1, 1984), and

(II) is part of a surface mining and reclamation permit granted under the provisions of title V of such Act (as so in effect), or

(ii) which is submitted pursuant to any other Federal or State law which imposes surface mining reclamation and permit requirements substantially similar to the requirements imposed by title V of such Act (as so in effect).

(B) Solid waste disposal and closing costs

(i) In general

Any expenses incurred for any land reclamation or closing activity in connection with any solid waste disposal site which is conducted in accordance with any permit issued pursuant to—

(I) any provision of the Solid Waste Disposal Act (as in effect on January 1, 1984) requiring such activity, or

(II) any other Federal, State, or local law which imposes requirements substantially similar to the requirements imposed by the Solid Waste Disposal Act (as so in effect).

(ii) Exception for certain hazardous waste sites

Clause (i) shall not apply to that portion of any property which is disturbed after the property is listed in the national contingency plan established under section 105 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980.

(3) Property

The term “property” has the meaning given such term by section 614.

(4) Reserve property

The term “reserve property” means any property with respect to which a reserve is established under subsection (a)(1).

(Added Pub. L. 98-369, div. A, title I, §91(b)(1), July 18, 1984, 98 Stat. 601; amended Pub. L. 99-514, title XVIII, §§1807(a)(3)(A), (C), 1899A(14), Oct. 22, 1986, 100 Stat. 2811, 2959; Pub. L. 101-508, title XI, §11802(c), Nov. 5, 1990, 104 Stat. 1388-529.)

REFERENCES IN TEXT

The Surface Mining Control and Reclamation Act of 1977, referred to in subsec. (d)(2)(A), is Pub. L. 95-87, Aug. 3, 1977, 91 Stat. 445, as amended. Title V of that Act is classified generally to subchapter V (§1251 et seq.) of chapter 25 of Title 30, Mineral Lands and Mining. Sections 511 and 528 of that Act are classified to sections 1261 and 1278, respectively, of Title 30. For complete classification of this Act to the Code, see Short Title note set out under section 1201 of Title 30 and Tables.

The Solid Waste Disposal Act, referred to in subsec. (d)(2)(B)(i), is title II of Pub. L. 89-272, Oct. 20, 1965, 79 Stat. 997, as amended generally by Pub. L. 94-580, §2, Oct. 21, 1976, 90 Stat. 2795, which is classified generally to chapter 82 (§6901 et seq.) of Title 42, The Public Health and Welfare. For complete classification of this Act to the Code, see Short Title note set out under section 6901 of Title 42 and Tables.

Section 105 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, referred to in subsec. (d)(2)(B)(ii), is classified to section 9605 of Title 42.

AMENDMENTS

1990—Subsec. (a)(2)(B). Pub. L. 101-508 amended subpar. (B) generally, substituting present provisions for provisions providing for increase for interest and a phase-in of interest rates for taxable years ending before 1987.

1986—Subsec. (a)(1). Pub. L. 99-514, §1807(a)(3)(C), substituted “this section” for “this subsection”.

Subsec. (a)(2)(D). Pub. L. 99-514, §1807(a)(3)(A), added subpar. (D).

Subsec. (d)(2)(B)(ii). Pub. L. 99-514, §1899A(14), substituted “Comprehensive Environmental Response, Compensation, and Liability Act of 1980” for “Comprehensive Environmental, Compensation, and Liability Act of 1980”.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 1807(a)(3)(A), (C) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section effective July 18, 1984, with respect to taxable years ending after such date, except as otherwise provided, see section 91(g)(4) of Pub. L. 98-369, as amended, set out as an Effective Date of 1984 Amendment note under section 461 of this title.

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 468A. Special rules for nuclear decommissioning costs

(a) In general

If the taxpayer elects the application of this section, there shall be allowed as a deduction for any taxable year the amount of payments made by the taxpayer to a Nuclear Decommissioning Reserve Fund (hereinafter referred to as the “Fund”) during such taxable year.

(b) Limitation on amounts paid into Fund

The amount which a taxpayer may pay into the Fund for any taxable year shall not exceed the ruling amount applicable to such taxable year.

(c) Income and deductions of the taxpayer

(1) Inclusion of amounts distributed

There shall be includible in the gross income of the taxpayer for any taxable year—

(A) any amount distributed from the Fund during such taxable year, other than any amount distributed to pay costs described in subsection (e)(4)(B), and

(B) except to the extent provided in regulations, amounts properly includible in gross income in the case of any deemed distribution under subsection (e)(6), any termination under subsection (e)(7), or the disposition of any interest in the nuclear powerplant.

(2) Deduction when economic performance occurs

In addition to any deduction under subsection (a), there shall be allowable as a deduction for any taxable year the amount of the nuclear decommissioning costs with respect to which economic performance (within the meaning of section 461(h)(2)) occurs during such taxable year.

(d) Ruling amount

For purposes of this section—

(1) Request required

No deduction shall be allowed for any payment to the Fund unless the taxpayer re-

quests, and receives, from the Secretary a schedule of ruling amounts. For purposes of the preceding sentence, the taxpayer shall request a schedule of ruling amounts upon each renewal of the operating license of the nuclear powerplant.

(2) Ruling amount

The term “ruling amount” means, with respect to any taxable year, the amount which the Secretary determines under paragraph (1) to be necessary to—

(A) fund the total nuclear decommissioning costs with respect to such power plant over the estimated useful life of such power plant, and

(B) prevent any excessive funding of such costs or the funding of such costs at a rate more rapid than level funding, taking into account such discount rates as the Secretary deems appropriate.

(3) Review of amount

The Secretary shall at least once during the useful life of the nuclear powerplant (or, more frequently, upon the request of the taxpayer) review, and revise if necessary, the schedule of ruling amounts determined under paragraph (1).

(e) Nuclear Decommissioning Reserve Fund

(1) In general

Each taxpayer who elects the application of this section shall establish a Nuclear Decommissioning Reserve Fund with respect to each nuclear powerplant to which such election applies.

(2) Taxation of Fund

(A) In general

There is hereby imposed on the gross income of the Fund for any taxable year a tax at the rate of 20 percent, except that—

(i) there shall not be included in the gross income of the Fund any payment to the Fund with respect to which a deduction is allowable under subsection (a), and

(ii) there shall be allowed as a deduction to the Fund any amount paid by the Fund which is described in paragraph (4)(B) (other than an amount paid to the taxpayer) and which would be deductible under this chapter for purposes of determining the taxable income of a corporation.

(B) Tax in lieu of other taxation

The tax imposed by subparagraph (A) shall be in lieu of any other taxation under this subtitle of the income from assets in the Fund.

(C) Fund treated as corporation

For purposes of subtitle F—

(i) the Fund shall be treated as if it were a corporation, and

(ii) any tax imposed by this paragraph shall be treated as a tax imposed by section 11.

(3) Contributions to Fund

Except as provided in subsection (f), the Fund shall not accept any payments (or other

amounts) other than payments with respect to which a deduction is allowable under subsection (a).

(4) Use of Fund

The Fund shall be used exclusively for—

(A) satisfying, in whole or in part, any liability of any person contributing to the Fund for the decommissioning of a nuclear powerplant (or unit thereof),

(B) to pay administrative costs (including taxes) and other incidental expenses of the Fund (including legal, accounting, actuarial, and trustee expenses) in connection with the operation of the Fund, and

(C) to the extent that a portion of the Fund is not currently needed for purposes described in subparagraph (A) or (B), making investments.

(5) Prohibitions against self-dealing

Under regulations prescribed by the Secretary, for purposes of section 4951 (and so much of this title as relates to such section), the Fund shall be treated in the same manner as a trust described in section 501(c)(21).

(6) Disqualification of Fund

In any case in which the Fund violates any provision of this section or section 4951, the Secretary may disqualify such Fund from the application of this section. In any case to which this paragraph applies, the Fund shall be treated as having distributed all of its funds on the date such determination takes effect.

(7) Termination upon completion

Upon substantial completion of the nuclear decommissioning of the nuclear powerplant with respect to which a Fund relates, the taxpayer shall terminate such Fund.

(f) Transfers into qualified funds

(1) In general

Notwithstanding subsection (b), any taxpayer maintaining a Fund to which this section applies with respect to a nuclear power plant may transfer into such Fund not more than an amount equal to the present value of the portion of the total nuclear decommissioning costs with respect to such nuclear power plant previously excluded for such nuclear power plant under subsection (d)(2)(A) as in effect immediately before the date of the enactment of this subsection.

(2) Deduction for amounts transferred

(A) In general

Except as provided in subparagraph (C), the deduction allowed by subsection (a) for any transfer permitted by this subsection shall be allowed ratably over the remaining estimated useful life (within the meaning of subsection (d)(2)(A)) of the nuclear power plant beginning with the taxable year during which the transfer is made.

(B) Denial of deduction for previously deducted amounts

No deduction shall be allowed for any transfer under this subsection of an amount for which a deduction was previously al-

lowed to the taxpayer (or a predecessor) or a corresponding amount was not included in gross income of the taxpayer (or a predecessor). For purposes of the preceding sentence, a ratable portion of each transfer shall be treated as being from previously deducted or excluded amounts to the extent thereof.

(C) Transfers of qualified funds

If—

(i) any transfer permitted by this subsection is made to any Fund to which this section applies, and

(ii) such Fund is transferred thereafter,

any deduction under this subsection for taxable years ending after the date that such Fund is transferred shall be allowed to the transferor for the taxable year which includes such date.

(D) Special rules

(i) Gain or loss not recognized on transfers to Fund

No gain or loss shall be recognized on any transfer described in paragraph (1).

(ii) Transfers of appreciated property to Fund

If appreciated property is transferred in a transfer described in paragraph (1), the amount of the deduction shall not exceed the adjusted basis of such property.

(3) New ruling amount required

Paragraph (1) shall not apply to any transfer unless the taxpayer requests from the Secretary a new schedule of ruling amounts in connection with such transfer.

(4) No basis in qualified funds

Notwithstanding any other provision of law, the taxpayer's basis in any Fund to which this section applies shall not be increased by reason of any transfer permitted by this section.

(g) Nuclear powerplant

For purposes of this section, the term "nuclear powerplant" includes any unit thereof.

(h) Time when payments deemed made

For purposes of this section, a taxpayer shall be deemed to have made a payment to the Fund on the last day of a taxable year if such payment is made on account of such taxable year and is made within 2½ months after the close of such taxable year.

(Added Pub. L. 98-369, div. A, title I, §91(c)(1), July 18, 1984, 98 Stat. 604; amended Pub. L. 99-514, title XVIII, §1807(a)(4)(A)(i), (B)-(E)(vi), Oct. 22, 1986, 100 Stat. 2812, 2813; Pub. L. 102-486, title XIX, §1917(a), (b), Oct. 24, 1992, 106 Stat. 3024, 3025; Pub. L. 104-188, title I, §1704(j)(6), Aug. 20, 1996, 110 Stat. 1882; Pub. L. 109-58, title XIII, §1310(a)-(e), Aug. 8, 2005, 119 Stat. 1007-1009.)

REFERENCES IN TEXT

The date of the enactment of this subsection, referred to in subsec. (f)(1), is the date of enactment of Pub. L. 109-58, which was approved Aug. 8, 2005.

AMENDMENTS

2005—Subsec. (b). Pub. L. 109-58, §1310(a), reenacted heading without change and amended text of subsec. (b)

generally. Prior to amendment, text read as follows: "The amount which a taxpayer may pay into the Fund for any taxable year shall not exceed the lesser of—

"(1) the amount of nuclear decommissioning costs allocable to the Fund which is included in the taxpayer's cost of service for ratemaking purposes for such taxable year, or

"(2) the ruling amount applicable to such taxable year."

Subsec. (d)(1). Pub. L. 109-58, §1310(c), inserted at end "For purposes of the preceding sentence, the taxpayer shall request a schedule of ruling amounts upon each renewal of the operating license of the nuclear powerplant."

Subsec. (d)(2)(A). Pub. L. 109-58, §1310(b)(2), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: "fund that portion of the nuclear decommissioning costs of the taxpayer with respect to the nuclear powerplant which bears the same ratio to the total nuclear decommissioning costs with respect to such nuclear powerplant as the period for which the Fund is in effect bears to the estimated useful life of such nuclear powerplant, and"

Subsec. (e)(2)(A). Pub. L. 109-58, §1310(e)(1), substituted "rate of 20 percent" for "rate set forth in subparagraph (B)" in introductory provisions.

Subsec. (e)(2)(B) to (D). Pub. L. 109-58, §1310(e)(2), (3), redesignated subpars. (C) and (D) as (B) and (C), respectively, and struck out heading and text of former subpar. (B). Text read as follows: "For purposes of subparagraph (A), the rate set forth in this subparagraph is—

"(i) 22 percent in the case of taxable years beginning in calendar year 1994 or 1995, and

"(ii) 20 percent in the case of taxable years beginning after December 31, 1995."

Subsec. (e)(3). Pub. L. 109-58, §1310(d), substituted "Except as provided in subsection (f), the Fund" for "The Fund".

Subsecs. (f) to (h). Pub. L. 109-58, §1310(b)(1), added subsec. (f) and redesignated former subsecs. (f) and (g) as (g) and (h), respectively.

1996—Subsec. (e)(2)(A). Pub. L. 104-188 provided that the amendment made by section 1917(b)(1) of Pub. L. 102-486 shall be applied as if "at a rate" appeared instead of "at the rate" in the material proposed to be stricken. See 1992 Amendment note below.

1992—Subsec. (e)(2)(A). Pub. L. 102-486, §1917(b)(1), which directed that subpar. (A) be amended by striking "at the rate equal to the highest rate of tax specified in section 11(b)" and inserting "at the rate set forth in subparagraph (B)", was executed by making the substitution for "at a rate equal to the highest rate of tax specified in section 11(b)". See 1996 Amendment note above.

Subsec. (e)(2)(B) to (D). Pub. L. 102-486, §1917(b)(2), added subpar. (B) and redesignated former subpars. (B) and (C) as (C) and (D), respectively.

Subsec. (e)(4)(C). Pub. L. 102-486, §1917(a), struck out before period at end "described in section 501(c)(21)(B)(ii)".

1986—Subsec. (a). Pub. L. 99-514, §1807(a)(4)(E)(i), substituted "this section" for "this subsection".

Subsec. (c)(1)(A). Pub. L. 99-514, §1807(a)(4)(B), substituted "subsection (e)(4)(B)" for "subsection (e)(2)(B)".

Subsec. (d). Pub. L. 99-514, §1807(a)(4)(E)(ii), substituted "this section" for "this subsection" in introductory text.

Subsec. (e). Pub. L. 99-514, §1807(a)(4)(E)(iii), substituted "Reserve Fund" for "Trust Fund" in heading.

Subsec. (e)(1). Pub. L. 99-514, §1807(a)(4)(E)(iv), substituted "this section" for "this subsection" and "Reserve Fund" for "Trust Fund".

Subsec. (e)(2). Pub. L. 99-514, §1807(a)(4)(C), amended par. (2) generally. Prior to amendment, par. (2) read as follows: "There is imposed on the gross income of the Fund for any taxable year a tax at a rate equal to the maximum rate in effect under section 11(b), except that—

"(A) there shall not be included in the gross income of the Fund any payment to the Fund with respect to

which a deduction is allowable under subsection (a), and

“(B) there shall be allowed as a deduction any amount paid by the Fund described in paragraph (4)(B) (other than to the taxpayer).”

Subsec. (e)(4)(C). Pub. L. 99-514, §1807(a)(4)(D), added subpar. (C).

Subsec. (e)(6). Pub. L. 99-514, §1807(a)(4)(E)(v), substituted “this section” for “this subsection” in two places and “this paragraph” for “this subparagraph”.

Subsec. (f). Pub. L. 99-514, §1807(a)(4)(E)(vi), substituted “For purposes of this section, the” for “The”.

Subsec. (g). Pub. L. 99-514, §1807(a)(4)(A)(i), added subsec. (g).

EFFECTIVE DATE OF 2005 AMENDMENT

Pub. L. 109-58, title XIII, §1310(f), Aug. 8, 2005, 119 Stat. 1009, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2005.”

EFFECTIVE DATE OF 1992 AMENDMENT

Section 1917(c) of Pub. L. 102-486 provided that:

“(1) SUBSECTION (a).—The amendment made by subsection (a) [amending this section] shall apply to taxable years beginning after December 31, 1992.

“(2) SUBSECTION (b).—The amendments made by subsection (b) [amending this section] shall apply to taxable years beginning after December 31, 1993. Section 15 of the Internal Revenue Code of 1986 shall not apply to any change in rate resulting from the amendment made by subsection (b).”

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section effective July 18, 1984, with respect to taxable years ending after such date, see section 91(g)(5) of Pub. L. 98-369, as amended, set out as an Effective Date of 1984 Amendment note under section 461 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

TRANSITIONAL RULE

Section 1807(a)(4)(A)(ii) of Pub. L. 99-514 provided that: “To the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, subsection (g) of section 468A of the Internal Revenue Code of 1954 [now 1986] (as added by clause (i)) shall be applied with respect to any payment on account of a taxable year beginning before January 1, 1987, as if it did not contain the requirement that the payment be made within 2½ months after the close of the taxable year. Such regulations may provide that, to the extent such payment to the Fund is made more than 2½ months after the close of the taxable year, any adjustment to the tax attributable to such payment shall not affect the amount of interest payable with respect to periods before the payment is made. Such regulations may provide appropriate adjustments to the deduction allowed under such section 468A for any such taxable year to take into account the fact that the payment to the Fund is made more than 2½ months after the close of the taxable year.”

§ 468B. Special rules for designated settlement funds

(a) In general

For purposes of section 461(h), economic performance shall be deemed to occur as qualified payments are made by the taxpayer to a designated settlement fund.

(b) Taxation of designated settlement fund

(1) In general

There is imposed on the gross income of any designated settlement fund for any taxable year a tax at a rate equal to the maximum rate in effect for such taxable year under section 1(e).

(2) Certain expenses allowed

For purposes of paragraph (1), gross income for any taxable year shall be reduced by the amount of any administrative costs (including State and local taxes) and other incidental expenses of the designated settlement fund (including legal, accounting, and actuarial expenses)—

(A) which are incurred in connection with the operation of the fund, and

(B) which would be deductible under this chapter for purposes of determining the taxable income of a corporation.

No other deduction shall be allowed to the fund.

(3) Transfers to the fund

In the case of any qualified payment made to the fund—

(A) the amount of such payment shall not be treated as income of the designated settlement fund,

(B) the basis of the fund in any property which constitutes a qualified payment shall be equal to the fair market value of such property at the time of payment, and

(C) the fund shall be treated as the owner of the property in the fund (and any earnings thereon).

(4) Tax in lieu of other taxation

The tax imposed by paragraph (1) shall be in lieu of any other taxation under this subtitle of income from assets in the designated settlement fund.

(5) Coordination with subtitle F

For purposes of subtitle F—

(A) a designated settlement fund shall be treated as a corporation, and

(B) any tax imposed by this subsection shall be treated as a tax imposed by section 11.

(c) Deductions not allowed for transfer of insurance amounts

No deduction shall be allowable for any qualified payment by the taxpayer of any amounts received from the settlement of any insurance claim to the extent such amounts are excluded from the gross income of the taxpayer.

(d) Definitions

For purposes of this section—

(1) Qualified payment

The term “qualified payment” means any money or property which is transferred to any

designated settlement fund pursuant to a court order, other than—

(A) any amount which may be transferred from the fund to the taxpayer (or any related person), or

(B) the transfer of any stock or indebtedness of the taxpayer (or any related person).

(2) Designated settlement fund

The term “designated settlement fund” means any fund—

(A) which is established pursuant to a court order and which extinguishes completely the taxpayer’s tort liability with respect to claims described in subparagraph (D),

(B) with respect to which no amounts may be transferred other than in the form of qualified payments,

(C) which is administered by persons a majority of whom are independent of the taxpayer,

(D) which is established for the principal purpose of resolving and satisfying present and future claims against the taxpayer (or any related person or formerly related person) arising out of personal injury, death, or property damage,

(E) under the terms of which the taxpayer (or any related person) may not hold any beneficial interest in the income or corpus of the fund, and

(F) with respect to which an election is made under this section by the taxpayer.

An election under this section shall be made at such time and in such manner as the Secretary shall by regulation prescribe. Such an election, once made, may be revoked only with the consent of the Secretary.

(3) Related person

The term “related person” means a person related to the taxpayer within the meaning of section 267(b).

(e) Nonapplicability of section

This section (other than subsection (g)) shall not apply with respect to any liability of the taxpayer arising under any workers’ compensation Act or any contested liability of the taxpayer within the meaning of section 461(f).

(f) Other funds

Except as provided in regulations, any payment in respect of a liability described in subsection (d)(2)(D) (and not described in subsection (e)) to a trust fund or escrow fund which is not a designated settlement fund shall not be treated as constituting economic performance.

(g) Clarification of taxation of certain funds

(1) In general

Except as provided in paragraph (2), nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

(2) Exemption from tax for certain settlement funds

An escrow account, settlement fund, or similar fund shall be treated as beneficially owned

by the United States and shall be exempt from taxation under this subtitle if—

(A) it is established pursuant to a consent decree entered by a judge of a United States District Court,

(B) it is created for the receipt of settlement payments as directed by a government entity for the sole purpose of resolving or satisfying one or more claims asserting liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980,

(C) the authority and control over the expenditure of funds therein (including the expenditure of contributions thereto and any net earnings thereon) is with such government entity, and

(D) upon termination, any remaining funds will be disbursed to such government entity for use in accordance with applicable law.

For purposes of this paragraph, the term “government entity” means the United States, any State or political subdivision thereof, the District of Columbia, any possession of the United States, and any agency or instrumentality of any of the foregoing.

(Added Pub. L. 99-514, title XVIII, §1807(a)(7)(A), Oct. 22, 1986, 100 Stat. 2814; amended Pub. L. 100-647, title I, §1018(f)(1), (2), (4), (5)(A), Nov. 10, 1988, 102 Stat. 3582; Pub. L. 101-508, title XI, §11702(e)(1), Nov. 5, 1990, 104 Stat. 1388-515; Pub. L. 109-222, title II, §201(a), May 17, 2006, 120 Stat. 347; Pub. L. 109-432, div. A, title IV, §409(a), Dec. 20, 2006, 120 Stat. 2963.)

REFERENCES IN TEXT

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980, referred to in subsec. (g)(2)(B), is Pub. L. 96-510, Dec. 11, 1980, 94 Stat. 2767, as amended, which is classified principally to chapter 103 (§9601 et seq.) of Title 42, The Public Health and Welfare. For complete classification of this Act to the Code, see Short Title note set out under section 9601 of Title 42 and Tables.

AMENDMENTS

2006—Subsec. (g). Pub. L. 109-222 reenacted heading without change and amended text of subsec. (g) generally. Prior to amendment, text read as follows: “Nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.”

Subsec. (g)(3). Pub. L. 109-432 struck out heading and text of par. (3). Text read as follows: “Paragraph (2) shall not apply to accounts and funds established after December 31, 2010.”

1990—Subsec. (e). Pub. L. 101-508 substituted “This section (other than subsection (g))” for “This section”.

1988—Subsec. (b)(2). Pub. L. 100-647, §1018(f)(4)(B), substituted “No other” for “no other” in concluding provisions.

Subsec. (b)(2)(B). Pub. L. 100-647, §1018(f)(4)(A), substituted “a corporation.” for “the corporation.”

Subsec. (d)(1)(A). Pub. L. 100-647, §1018(f)(1), inserted “(or any related person)” after “taxpayer”.

Subsec. (d)(2)(A). Pub. L. 100-647, §1018(f)(2), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: “which is established pursuant to a court order.”

Subsec. (d)(2)(E). Pub. L. 100-647, §1018(f)(1), inserted “(or any related person)” after “taxpayer”.

Subsec. (g). Pub. L. 100-647, §1018(f)(5)(A), added subsec. (g).

EFFECTIVE DATE OF 2006 AMENDMENT

Pub. L. 109-432, div. A, title IV, §409(b), Dec. 20, 2006, 120 Stat. 2963, provided that: “The amendment made by this section [amending this section] shall take effect as if included in section 201 of the Tax Increase Prevention and Reconciliation Act of 2005 [Pub. L. 109-222].”

Pub. L. 109-222, title II, §201(b), May 17, 2006, 120 Stat. 348, provided that: “The amendment made by subsection (a) [amending this section] shall apply to accounts and funds established after the date of the enactment of this Act [May 17, 2006].”

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101-508 effective as if included in the provision of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647, to which such amendment relates, see section 11702(j) of Pub. L. 101-508, set out as a note under section 59 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as an Effective Date of 1986 Amendment note under section 48 of this title.

**PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989**

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

**SPECIAL RULE FOR TAXPAYER IN BANKRUPTCY
REORGANIZATION**

Section 1807(a)(7)(C) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, §1018(f)(3), Nov. 10, 1988, 102 Stat. 3582, provided that: “In the case of any settlement fund which is established for claimants against a corporation which filed a petition for reorganization under chapter 11 of title 11, United States Code, on August 26, 1982, and which filed with a United States district court a first amended and restated plan of reorganization before March 1, 1986—

“(i) any portion of such fund which is established pursuant to a court order and with qualified payments, which meets the requirements of subparagraphs (C) and (D) of section 468B(d)(2) of the Internal Revenue Code of 1954 [now 1986] (as added by this paragraph), and with respect to which an election is made under subparagraph (F) thereof, shall be treated as a designated settlement fund for purposes of section 468B of such Code,

“(ii) such corporation (or any successor thereof) shall be liable for the tax imposed by section 468B of such Code on such portion of the fund (and the fund shall not be liable for such tax), such tax shall be deductible by the corporation, and the rate of tax under section 468B of such Code for any taxable year shall be equal to 15 percent, and

“(iii) any transaction by any portion of the fund not described in clause (i) shall be treated as a transaction made by the corporation.”

**CLARIFICATION OF LAW WITH RESPECT TO CERTAIN
FUNDS**

Section 1807(a)(7)(D) of Pub. L. 99-514 provided that nothing in any provision of law be construed as providing that an escrow account, settlement fund, or similar fund established after Aug. 16, 1986, not be subject to current income tax and that if contributions to such account or fund are not deductible then the account or fund be taxed as a grantor trust, prior to repeal by Pub. L. 100-647, title I, §1018(f)(5)(B), Nov. 10, 1988, 102 Stat. 3582.

§ 469. Passive activity losses and credits limited

(a) Disallowance

(1) In general

If for any taxable year the taxpayer is described in paragraph (2), neither—

- (A) the passive activity loss, nor
- (B) the passive activity credit,

for the taxable year shall be allowed.

(2) Persons described

The following are described in this paragraph:

- (A) any individual, estate, or trust,
- (B) any closely held C corporation, and
- (C) any personal service corporation.

(b) Disallowed loss or credit carried to next year

Except as otherwise provided in this section, any loss or credit from an activity which is disallowed under subsection (a) shall be treated as a deduction or credit allocable to such activity in the next taxable year.

(c) Passive activity defined

For purposes of this section—

(1) In general

The term “passive activity” means any activity—

- (A) which involves the conduct of any trade or business, and
- (B) in which the taxpayer does not materially participate.

(2) Passive activity includes any rental activity

Except as provided in paragraph (7), the term “passive activity” includes any rental activity.

(3) Working interests in oil and gas property

(A) In general

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

(B) Income in subsequent years

If any taxpayer has any loss for any taxable year from a working interest in any oil or gas property which is treated as a loss which is not from a passive activity, then any net income from such property (or any property the basis of which is determined in whole or in part by reference to the basis of such property) for any succeeding taxable year shall be treated as income of the taxpayer which is not from a passive activity. If the preceding sentence applies to the net in-

come from any property for any taxable year, any credits allowable under subpart B (other than section 27(a)) or D of part IV of subchapter A for such taxable year which are attributable to such property shall be treated as credits not from a passive activity to the extent the amount of such credits does not exceed the regular tax liability of the taxpayer for the taxable year which is allocable to such net income.

(4) Material participation not required for paragraphs (2) and (3)

Paragraphs (2) and (3) shall be applied without regard to whether or not the taxpayer materially participates in the activity.

(5) Trade or business includes research and experimentation activity

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

(6) Activity in connection with trade or business or production of income

To the extent provided in regulations, for purposes of paragraph (1)(A), the term “trade or business” includes—

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

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

(7) Special rules for taxpayers in real property business

(A) In general

If this paragraph applies to any taxpayer for a taxable year—

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

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

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

(B) Taxpayers to whom paragraph applies

This paragraph shall apply to a taxpayer for a taxable year if—

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

(ii) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates.

In the case of a joint return, the requirements of the preceding sentence are satisfied

if and only if either spouse separately satisfies such requirements. For purposes of the preceding sentence, activities in which a spouse materially participates shall be determined under subsection (h).

(C) Real property trade or business

For purposes of this paragraph, the term “real property trade or business” means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

(D) Special rules for subparagraph (B)

(i) Closely held C corporations

In the case of a closely held C corporation, the requirements of subparagraph (B) shall be treated as met for any taxable year if more than 50 percent of the gross receipts of such corporation for such taxable year are derived from real property trades or businesses in which the corporation materially participates.

(ii) Personal services as an employee

For purposes of subparagraph (B), personal services performed as an employee shall not be treated as performed in real property trades or businesses. The preceding sentence shall not apply if such employee is a 5-percent owner (as defined in section 416(i)(1)(B)) in the employer.

(d) Passive activity loss and credit defined

For purposes of this section—

(1) Passive activity loss

The term “passive activity loss” means the amount (if any) by which—

(A) the aggregate losses from all passive activities for the taxable year, exceed

(B) the aggregate income from all passive activities for such year.

(2) Passive activity credit

The term “passive activity credit” means the amount (if any) by which—

(A) the sum of the credits from all passive activities allowable for the taxable year under—

(i) subpart D of part IV of subchapter A, or

(ii) subpart B (other than section 27(a)) of such part IV, exceeds

(B) the regular tax liability of the taxpayer for the taxable year allocable to all passive activities.

(e) Special rules for determining income or loss from a passive activity

For purposes of this section—

(1) Certain income not treated as income from passive activity

In determining the income or loss from any activity—

(A) In general

There shall not be taken into account—

(i) any—

(I) gross income from interest, dividends, annuities, or royalties not derived

in the ordinary course of a trade or business,

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

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

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

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

(II) held for investment.

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

(B) Return on working capital

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

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

(A) In general

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

(i) shall be allowable as a deduction against net active income, and

(ii) shall not be taken into account under subsection (a) to the extent so allowable as a deduction.

A similar rule shall apply in the case of any passive activity credit of the taxpayer.

(B) Net active income

For purposes of this paragraph, the term “net active income” means the taxable income of the taxpayer for the taxable year determined without regard to—

(i) any income or loss from a passive activity, and

(ii) any item of gross income, expense, gain, or loss described in paragraph (1)(A).

(3) Compensation for personal services

Earned income (within the meaning of section 911(d)(2)(A)) shall not be taken into account in computing the income or loss from a passive activity for any taxable year.

(4) Dividends reduced by dividends received deduction

For purposes of paragraphs (1) and (2), income from dividends shall be reduced by the amount of any dividends received deduction under section 243, 244, or 245.

(f) Treatment of former passive activities

For purposes of this section—

(1) In general

If an activity is a former passive activity for any taxable year—

(A) any unused deduction allocable to such activity under subsection (b) shall be offset

against the income from such activity for the taxable year,

(B) any unused credit allocable to such activity under subsection (b) shall be offset against the regular tax liability (computed after the application of paragraph (1)) allocable to such activity for the taxable year, and

(C) any such deduction or credit remaining after the application of subparagraphs (A) and (B) shall continue to be treated as arising from a passive activity.

(2) Change in status of closely held C corporation or personal service corporation

If a taxpayer ceases for any taxable year to be a closely held C corporation or personal service corporation, this section shall continue to apply to losses and credits to which this section applied for any preceding taxable year in the same manner as if such taxpayer continued to be a closely held C corporation or personal service corporation, whichever is applicable.

(3) Former passive activity

The term “former passive activity” means any activity which, with respect to the taxpayer—

(A) is not a passive activity for the taxable year, but

(B) was a passive activity for any prior taxable year.

(g) Dispositions of entire interest in passive activity

If during the taxable year a taxpayer disposes of his entire interest in any passive activity (or former passive activity), the following rules shall apply:

(1) Fully taxable transaction

(A) In general

If all gain or loss realized on such disposition is recognized, the excess of—

(i) any loss from such activity for such taxable year (determined after the application of subsection (b)), over

(ii) any net income or gain for such taxable year from all other passive activities (determined after the application of subsection (b)),

shall be treated as a loss which is not from a passive activity.

(B) Subparagraph (A) not to apply to disposition involving related party

If the taxpayer and the person acquiring the interest bear a relationship to each other described in section 267(b) or section 707(b)(1), then subparagraph (A) shall not apply to any loss of the taxpayer until the taxable year in which such interest is acquired (in a transaction described in subparagraph (A)) by another person who does not bear such a relationship to the taxpayer.

(C) Income from prior years

To the extent provided in regulations, income or gain from the activity for preceding taxable years shall be taken into account under subparagraph (A)(ii) for the taxable

year to the extent necessary to prevent the avoidance of this section.

(2) Disposition by death

If an interest in the activity is transferred by reason of the death of the taxpayer—

(A) paragraph (1)(A) shall apply to losses described in paragraph (1)(A) to the extent such losses are greater than the excess (if any) of—

(i) the basis of such property in the hands of the transferee, over

(ii) the adjusted basis of such property immediately before the death of the taxpayer, and

(B) any losses to the extent of the excess described in subparagraph (A) shall not be allowed as a deduction for any taxable year.

(3) Installment sale of entire interest

In the case of an installment sale of an entire interest in an activity to which section 453 applies, paragraph (1) shall apply to the portion of such losses for each taxable year which bears the same ratio to all such losses as the gain recognized on such sale during such taxable year bears to the gross profit from such sale (realized or to be realized when payment is completed).

(h) Material participation defined

For purposes of this section—

(1) In general

A taxpayer shall be treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is—

- (A) regular,
- (B) continuous, and
- (C) substantial.

(2) Interests in limited partnerships

Except as provided in regulations, no interest in a limited partnership as a limited partner shall be treated as an interest with respect to which a taxpayer materially participates.

(3) Treatment of certain retired individuals and surviving spouses

A taxpayer shall be treated as materially participating in any farming activity for a taxable year if paragraph (4) or (5) of section 2032A(b) would cause the requirements of section 2032A(b)(1)(C)(ii) to be met with respect to real property used in such activity if such taxpayer had died during the taxable year.

(4) Certain closely held C corporations and personal service corporations

A closely held C corporation or personal service corporation shall be treated as materially participating in an activity only if—

(A) 1 or more shareholders holding stock representing more than 50 percent (by value) of the outstanding stock of such corporation materially participate in such activity, or

(B) in the case of a closely held C corporation (other than a personal service corporation), the requirements of section 465(c)(7)(C) (without regard to clause (iv)) are met with respect to such activity.

(5) Participation by spouse

In determining whether a taxpayer materially participates, the participation of the

spouse of the taxpayer shall be taken into account.

(i) \$25,000 offset for rental real estate activities

(1) In general

In the case of any natural person, subsection (a) shall not apply to that portion of the passive activity loss or the deduction equivalent (within the meaning of subsection (j)(5)) of the passive activity credit for any taxable year which is attributable to all rental real estate activities with respect to which such individual actively participated in such taxable year (and if any portion of such loss or credit arose in another taxable year, in such other taxable year).

(2) Dollar limitation

The aggregate amount to which paragraph (1) applies for any taxable year shall not exceed \$25,000.

(3) Phase-out of exemption

(A) In general

In the case of any taxpayer, the \$25,000 amount under paragraph (2) shall be reduced (but not below zero) by 50 percent of the amount by which the adjusted gross income of the taxpayer for the taxable year exceeds \$100,000.

(B) Special phase-out of rehabilitation credit

In the case of any portion of the passive activity credit for any taxable year which is attributable to the rehabilitation credit determined under section 47, subparagraph (A) shall be applied by substituting “\$200,000” for “\$100,000”.

(C) Exception for commercial revitalization deduction

Subparagraph (A) shall not apply to any portion of the passive activity loss for any taxable year which is attributable to the commercial revitalization deduction under section 1400I.

(D) Exception for low-income housing credit

Subparagraph (A) shall not apply to any portion of the passive activity credit for any taxable year which is attributable to any credit determined under section 42.

(E) Ordering rules to reflect exceptions and separate phase-outs

If subparagraph (B), (C), or (D) applies for a taxable year, paragraph (1) shall be applied—

(i) first to the portion of the passive activity loss to which subparagraph (C) does not apply,

(ii) second to the portion of such loss to which subparagraph (C) applies,

(iii) third to the portion of the passive activity credit to which subparagraph (B) or (D) does not apply,

(iv) fourth to the portion of such credit to which subparagraph (B) applies, and

(v) then to the portion of such credit to which subparagraph (D) applies.

(F) Adjusted gross income

For purposes of this paragraph, adjusted gross income shall be determined without regard to—

- (i) any amount includible in gross income under section 86,
- (ii) the amounts excludable from gross income under sections 135 and 137,
- (iii) the amounts allowable as a deduction under sections 199, 219, 221, and 222, and
- (iv) any passive activity loss or any loss allowable by reason of subsection (c)(7).

(4) Special rule for estates

(A) In general

In the case of taxable years of an estate ending less than 2 years after the date of the death of the decedent, this subsection shall apply to all rental real estate activities with respect to which such decedent actively participated before his death.

(B) Reduction for surviving spouse's exemption

For purposes of subparagraph (A), the \$25,000 amount under paragraph (2) shall be reduced by the amount of the exemption under paragraph (1) (without regard to paragraph (3)) allowable to the surviving spouse of the decedent for the taxable year ending with or within the taxable year of the estate.

(5) Married individuals filing separately

(A) In general

Except as provided in subparagraph (B), in the case of any married individual filing a separate return, this subsection shall be applied by substituting—

- (i) "\$12,500" for "\$25,000" each place it appears,
- (ii) "\$50,000" for "\$100,000" in paragraph (3)(A), and
- (iii) "\$100,000" for "\$200,000" in paragraph (3)(B).

(B) Taxpayers not living apart

This subsection shall not apply to a taxpayer who—

- (i) is a married individual filing a separate return for any taxable year, and
- (ii) does not live apart from his spouse at all times during such taxable year.

(6) Active participation

(A) In general

An individual shall not be treated as actively participating with respect to any interest in any rental real estate activity for any period if, at any time during such period, such interest (including any interest of the spouse of the individual) is less than 10 percent (by value) of all interests in such activity.

(B) No participation requirement for low-income housing, rehabilitation credit, or commercial revitalization deduction

Paragraphs (1) and (4)(A) shall be applied without regard to the active participation requirement in the case of—

- (i) any credit determined under section 42 for any taxable year,
- (ii) any rehabilitation credit determined under section 47, or

- (iii) any deduction under section 1400I (relating to commercial revitalization deduction).

(C) Interest as a limited partner

Except as provided in regulations, no interest as a limited partner in a limited partnership shall be treated as an interest with respect to which the taxpayer actively participates.

(D) Participation by spouse

In determining whether a taxpayer actively participates, the participation of the spouse of the taxpayer shall be taken into account.

(j) Other definitions and special rules

For purposes of this section—

(1) Closely held C corporation

The term "closely held C corporation" means any C corporation described in section 465(a)(1)(B).

(2) Personal service corporation

The term "personal service corporation" has the meaning given such term by section 269A(b)(1), except that section 269A(b)(2) shall be applied—

- (A) by substituting "any" for "more than 10 percent", and
- (B) by substituting "any" for "50 percent or more in value" in section 318(a)(2)(C).

A corporation shall not be treated as a personal service corporation unless more than 10 percent of the stock (by value) in such corporation is held by employee-owners (within the meaning of section 269A(b)(2), as modified by the preceding sentence).

(3) Regular tax liability

The term "regular tax liability" has the meaning given such term by section 26(b).

(4) Allocation of passive activity loss and credit

The passive activity loss and the passive activity credit (and the \$25,000 amount under subsection (i)) shall be allocated to activities, and within activities, on a pro rata basis in such manner as the Secretary may prescribe.

(5) Deduction equivalent

The deduction equivalent of credits from a passive activity for any taxable year is the amount which (if allowed as a deduction) would reduce the regular tax liability for such taxable year by an amount equal to such credits.

(6) Special rule for gifts

In the case of a disposition of any interest in a passive activity by gift—

- (A) the basis of such interest immediately before the transfer shall be increased by the amount of any passive activity losses allocable to such interest with respect to which a deduction has not been allowed by reason of subsection (a), and
- (B) such losses shall not be allowable as a deduction for any taxable year.

(7) Qualified residence interest

The passive activity loss of a taxpayer shall be computed without regard to qualified resi-

dence interest (within the meaning of section 163(h)(3)).

(8) Rental activity

The term “rental activity” means any activity where payments are principally for the use of tangible property.

(9) Election to increase basis of property by amount of disallowed credit

For purposes of determining gain or loss from a disposition of any property to which subsection (g)(1) applies, the transferor may elect to increase the basis of such property immediately before the transfer by an amount equal to the portion of any unused credit allowable under this chapter which reduced the basis of such property for the taxable year in which such credit arose. If the taxpayer elects the application of this paragraph, such portion of the passive activity credit of such taxpayer shall not be allowed for any taxable year.

(10) Coordination with section 280A

If a passive activity involves the use of a dwelling unit to which section 280A(c)(5) applies for any taxable year, any income, deduction, gain, or loss allocable to such use shall not be taken into account for purposes of this section for such taxable year.

(11) Aggregation of members of affiliated groups

Except as provided in regulations, all members of an affiliated group which files a consolidated return shall be treated as 1 corporation.

(12) Special rule for distributions by estates or trusts

If any interest in a passive activity is distributed by an estate or trust—

(A) the basis of such interest immediately before such distribution shall be increased by the amount of any passive activity losses allocable to such interest, and

(B) such losses shall not be allowable as a deduction for any taxable year.

(k) Separate application of section in case of publicly traded partnerships

(1) In general

This section shall be applied separately with respect to items attributable to each publicly traded partnership (and subsection (i) shall not apply with respect to items attributable to any such partnership). The preceding sentence shall not apply to any credit determined under section 42, or any rehabilitation credit determined under section 47, attributable to a publicly traded partnership to the extent the amount of any such credits exceeds the regular tax liability attributable to income from such partnership.

(2) Publicly traded partnership

For purposes of this section, the term “publicly traded partnership” means any partnership if—

(A) interests in such partnership are traded on an established securities market, or

(B) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

(3) Coordination with subsection (g)

For purposes of subsection (g), a taxpayer shall not be treated as having disposed of his entire interest in an activity of a publicly traded partnership until he disposes of his entire interest in such partnership.

(4) Application to regulated investment companies

For purposes of this section, a regulated investment company (as defined in section 851) holding an interest in a qualified publicly traded partnership (as defined in section 851(h)) shall be treated as a taxpayer described in subsection (a)(2) with respect to items attributable to such interest.

(l) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out provisions of this section, including regulations—

(1) which specify what constitutes an activity, material participation, or active participation for purposes of this section,

(2) which provide that certain items of gross income will not be taken into account in determining income or loss from any activity (and the treatment of expenses allocable to such income),

(3) requiring net income or gain from a limited partnership or other passive activity to be treated as not from a passive activity,

(4) which provide for the determination of the allocation of interest expense for purposes of this section, and

(5) which deal with changes in marital status and changes between joint returns and separate returns.

(m) Phase-in of disallowance of losses and credits for interest held before date of enactment

(1) In general

In the case of any passive activity loss or passive activity credit for any taxable year beginning in calendar years 1987 through 1990, subsection (a) shall not apply to the applicable percentage of that portion of such loss (or such credit) which is attributable to pre-enactment interests.

(2) Applicable percentage

For purposes of this subsection, the applicable percentage shall be determined in accordance with the following table:

In the case of taxable years beginning in:	The applicable percentage is:
1987	65
1988	40
1989	20
1990	10.

(3) Portion of loss or credit attributable to pre-enactment interests

For purposes of this subsection—

(A) In general

The portion of the passive activity loss (or passive activity credit) for any taxable year which is attributable to pre-enactment interests is the lesser of—

(i) the amount of the passive activity loss (or passive activity credit) which is

disallowed for the taxable year under subsection (a) (without regard to this subsection), or

(ii) the amount of the passive activity loss (or passive activity credit) which would be disallowed for the taxable year (without regard to this subsection and without regard to any amount allocable to an activity for the taxable year under subsection (b)) taking into account only pre-enactment interests.

(B) Pre-enactment interest

(i) In general

The term “pre-enactment interest” means any interest in a passive activity held by a taxpayer on the date of the enactment of the Tax Reform Act of 1986, and at all times thereafter.

(ii) Binding contract exception

For purposes of clause (i), any interest acquired after such date of enactment pursuant to a written binding contract in effect on such date, and at all times thereafter, shall be treated as held on such date.

(iii) Interest in activities

The term “pre-enactment interest” shall not include an interest in a passive activity unless such activity was being conducted on such date of enactment. The preceding sentence shall not apply to an activity commencing after such date if—

(I) the property used in such activity is acquired pursuant to a written binding contract in effect on August 16, 1986, and at all times thereafter, or

(II) construction of property used in such activity began on or before August 16, 1986.

(Added Pub. L. 99-514, title V, §501(a), Oct. 22, 1986, 100 Stat. 2233; amended Pub. L. 100-203, title X, §10212(a), Dec. 22, 1987, 101 Stat. 1330-405; Pub. L. 100-647, title I, §1005(a)(1)-(9), (11), (12), title II, §2004(g), title VI, §6009(c)(3), Nov. 10, 1988, 102 Stat. 3387-3389, 3603, 3690; Pub. L. 101-239, title VII, §7109(a), Dec. 19, 1989, 103 Stat. 2322; Pub. L. 101-508, title XI, §§11704(a)(6), 11813(b)(16), Nov. 5, 1990, 104 Stat. 1388-518, 1388-555; Pub. L. 103-66, title XIII, §13143(a), (b), Aug. 10, 1993, 107 Stat. 440, 441; Pub. L. 104-188, title I, §§1704(d)(1), (e)(1), 1807(c)(4), Aug. 20, 1996, 110 Stat. 1878, 1902; Pub. L. 105-277, div. J, title IV, §4003(a)(2)(D), Oct. 21, 1998, 112 Stat. 2681-908; Pub. L. 106-554, §1(a)(7) [title I, §101(b)], Dec. 21, 2000, 114 Stat. 2763, 2763A-599; Pub. L. 107-16, title IV, §431(c)(3), June 7, 2001, 115 Stat. 68; Pub. L. 107-147, title IV, §412(a), Mar. 9, 2002, 116 Stat. 53; Pub. L. 108-357, title I, §102(d)(5), title III, §331(g), Oct. 22, 2004, 118 Stat. 1429, 1477.)

AMENDMENT OF SECTION

For termination of amendment by section 901 of Pub. L. 107-16, see Effective and Termination Dates of 2001 Amendment note below.

REFERENCES IN TEXT

The date of the enactment of the Tax Reform Act of 1986, referred to in subsec. (m)(3)(B), is the date of enactment of Pub. L. 99-514, which was approved Oct. 22, 1986.

AMENDMENTS

2004—Subsec. (i)(3)(F)(iii). Pub. L. 108-357, §102(d)(5), inserted “199,” before “219.”

Subsec. (k)(4). Pub. L. 108-357, §331(g), added par. (4).

2002—Subsec. (i)(3)(E)(ii) to (iv). Pub. L. 107-147 added cls. (ii) to (iv) and struck out former cls. (ii) to (iv) which read as follows:

“(ii) second to the portion of the passive activity credit to which subparagraph (B) or (D) does not apply,

“(iii) third to the portion of such credit to which subparagraph (B) applies,

“(iv) fourth to the portion of such loss to which subparagraph (C) applies, and”.

2001—Subsec. (i)(3)(F)(iii). Pub. L. 107-16, §§431(c)(3), 901, temporarily substituted “, 221, and 222” for “and 221”. See Effective and Termination Dates of 2001 Amendment note below.

2000—Subsec. (i)(3)(C) to (F). Pub. L. 106-554, §1(a)(7) [title I, §101(b)(1), (2)], added subpar. (C), redesignated former subpars. (C) to (E) as (D) to (F), respectively, and generally amended heading and text of subpar. (E), as redesignated. Prior to amendment, text read as follows: “If subparagraph (B) or (C) applies for any taxable year, paragraph (1) shall be applied—

“(i) first to the passive activity loss,

“(ii) second to the portion of the passive activity credit to which subparagraph (B) or (C) does not apply,

“(iii) third to the portion of such credit to which subparagraph (B) applies, and

“(iv) then to the portion of such credit to which subparagraph (C) applies.”

Subsec. (i)(6)(B). Pub. L. 106-554, §1(a)(7) [title I, §101(b)(3)(B)], substituted “, rehabilitation credit, or commercial revitalization deduction” for “or rehabilitation credit” in heading.

Subsec. (i)(6)(B)(iii). Pub. L. 106-554, §1(a)(7) [title I, §101(b)(3)(A)], added cl. (iii).

1998—Subsec. (i)(3)(E)(iii). Pub. L. 105-277 amended cl. (iii) generally. Prior to amendment, cl. (iii) read as follows: “any amount allowable as a deduction under section 219, and”.

1996—Subsec. (c)(3)(B). Pub. L. 104-188, §1704(d)(1), inserted at end “If the preceding sentence applies to the net income from any property for any taxable year, any credits allowable under subpart B (other than section 27(a)) or D of part IV of subchapter A for such taxable year which are attributable to such property shall be treated as credits not from a passive activity to the extent the amount of such credits does not exceed the regular tax liability of the taxpayer for the taxable year which is allocable to such net income.”

Subsec. (g)(1)(A). Pub. L. 104-188, §1704(e)(1), reenacted heading without change and amended text generally. Prior to amendment, text read as follows: “If all gain or loss realized on such disposition is recognized, the excess of—

“(i) the sum of—

“(I) any loss from such activity for such taxable year (determined after application of subsection (b)), plus

“(II) any loss realized on such disposition, over

“(ii) net income or gain for such taxable year from all passive activities (determined without regard to losses described in clause (i)), shall be treated as a loss which is not from a passive activity.”

Subsec. (i)(3)(E)(ii). Pub. L. 104-188, §1807(c)(4), amended cl. (ii) generally. Prior to amendment, cl. (ii) read as follows: “the amount excludable from gross income under section 135.”

1993—Subsec. (c)(2). Pub. L. 103-66, §13143(b)(1), substituted “Except as provided in paragraph (7), the” for “The”.

Subsec. (c)(7). Pub. L. 103-66, §13143(a), added par. (7).

Subsec. (i)(3)(E)(iv). Pub. L. 103-66, §13143(b)(2), inserted “or any loss allowable by reason of subsection (c)(7)” after “loss”.

1990—Subsec. (i)(3)(B), (6)(B)(ii). Pub. L. 101-508, §11813(b)(16)(A), substituted “rehabilitation credit de-

terminated under section 47” for “rehabilitation investment credit (within the meaning of section 48(o))”.

Subsec. (k)(1). Pub. L. 101-508, §11813(b)(16)(B), substituted “rehabilitation credit determined under section 47” for “rehabilitation investment credit (within the meaning of section 48(o))”.

Subsec. (m)(3)(A). Pub. L. 101-508, §11704(a)(6), substituted “pre-enactment” for “preenactment”.

1989—Subsec. (i)(3)(B), (C). Pub. L. 101-239 added subpars. (B) and (C) and struck out former subpars. (B) and (C) which read as follows:

“(B) SPECIAL PHASE-OUT OF LOW-INCOME HOUSING AND REHABILITATION CREDITS.—In the case of any portion of the passive activity credit for any taxable year which is attributable to any credit to which paragraph (6)(B) applies, subparagraph (A) shall be applied by substituting ‘\$200,000’ for ‘\$100,000’.

“(C) ORDERING RULE TO REFLECT SEPARATE PHASE-OUTS.—If subparagraph (B) applies for any taxable year, paragraph (1) shall be applied—

“(i) first to the passive activity loss,

“(ii) second to the portion of the passive activity credit to which subparagraph (B) does not apply, and

“(iii) then to the portion of such credit to which subparagraph (B) applies.”

Subsec. (i)(3)(D), (E). Pub. L. 101-239 added subpar. (D) and redesignated former subpar. (D) as (E).

1988—Subsec. (e)(1)(A)(ii). Pub. L. 100-647, §1005(a)(1), inserted “not derived in the ordinary course of a trade or business which is” after “gain or loss”.

Subsec. (g)(1)(A). Pub. L. 100-647, §1005(a)(2)(A), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: “If all gain or loss realized on such disposition is recognized, any loss from such activity which has not previously been allowed as a deduction (and in the case of a passive activity for the taxable year, any loss realized on such disposition) shall not be treated as a passive activity loss and shall be allowable as a deduction against income in the following order:

“(i) Income or gain from the passive activity for the taxable year (including any gain recognized on the disposition).

“(ii) Net income or gain for the taxable year from all passive activities.

“(iii) Any other income or gain.”

Subsec. (g)(1)(C). Pub. L. 100-647, §1005(a)(2)(B), substituted “Income from prior years” for “Coordination with section 1211” in heading and amended text generally. Prior to amendment, text read as follows: “In the case of any loss realized on the disposition of an interest in a passive activity, section 1211 shall be applied before subparagraph (A) is applied.”

Subsec. (g)(2)(A). Pub. L. 100-647, §1005(a)(3), substituted “paragraph (1)(A)” for “paragraph (1)” and “to losses described in paragraph (1)(A)” for “to such losses”.

Subsec. (g)(3). Pub. L. 100-647, §1005(a)(4), substituted “(realized or to be realized)” for “realized (or to be realized)” and “is completed)” for “is completed”.

Subsec. (h)(4). Pub. L. 100-647, §1005(a)(5), inserted “only” before “if”.

Subsec. (i)(1). Pub. L. 100-647, §1005(a)(6), substituted “in such taxable year (and if any portion of such loss or credit arose in another taxable year, in such other taxable year)” for “in the taxable year in which such portion of such loss or credit arose”.

Subsec. (i)(3)(D). Pub. L. 100-647, §6009(c)(3), added cl. (ii) and redesignated former cls. (ii) and (iii) as (iii) and (iv), respectively.

Subsec. (i)(6)(C). Pub. L. 100-647, §1005(a)(7), substituted “Except as provided in regulations, no” for “No”.

Subsec. (j)(6)(A). Pub. L. 100-647, §1005(a)(8), inserted “with respect to which a deduction has not been allowed by reason of subsection (a)” after “to such interest”.

Subsec. (j)(10), (11). Pub. L. 100-647, §1005(a)(9), added pars. (10) and (11).

Subsec. (j)(12). Pub. L. 100-647, §1005(a)(11), added par. (12).

Subsec. (k)(3). Pub. L. 100-647, §2004(g), added par. (3).
Subsec. (m). Pub. L. 100-647, §1005(a)(12), substituted “interest” for “interests” in heading.

Subsec. (m)(1). Pub. L. 100-647, §1005(a)(12), added par. (1) and struck out former par. (1) which read as follows: “In the case of any passive activity loss or credit for any taxable year beginning in calendar years 1987 through 1990 which—

“(A) is attributable to a pre-enactment interest,
but

“(B) is not attributable to a carryforward to such taxable year of any loss or credit which was disallowed under this section for a preceding taxable year.

there shall be disallowed under subsection (a) only the applicable percentage of the amount which (but for this subsection) would have been disallowed under subsection (a) for such taxable year.”

Subsec. (m)(2). Pub. L. 100-647, §1005(a)(12), added par. (2) and struck out former par. (2) which resulted in substituting “65”, “40”, “20”, and “10” for “35”, “60”, “80”, and “90” respectively, in second column.

Subsec. (m)(3)(A). Pub. L. 100-647, §1005(a)(12), added subpar. (A) and struck out former subpar. (A) which read as follows: “The portion of the passive activity loss for any taxable year which is attributable to pre-enactment interests shall be equal to the lesser of—

“(i) the passive activity loss for such taxable year,
or

“(ii) the passive activity loss for such taxable year determined by taking into account only pre-enactment interests.

For purposes of this subparagraph, the deduction equivalent (within the meaning of subsection (j)(5)) of a passive activity credit shall be taken into account.”

1987—Subsecs. (k) to (m). Pub. L. 100-203 added subsec. (k) and redesignated former subsecs. (k) and (l) as (l) and (m), respectively.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by section 102(d)(5) of Pub. L. 108-357 applicable to taxable years beginning after Dec. 31, 2004, see section 102(e) of Pub. L. 108-357, set out as a note under section 56 of this title.

Pub. L. 108-357, title III, §331(h), Oct. 22, 2004, 118 Stat. 1477, provided that: “The amendments made by this section [amending this section and sections 851 and 7704 of this title] shall apply to taxable years beginning after the date of the enactment of this Act [Oct. 22, 2004].”

EFFECTIVE DATE OF 2002 AMENDMENT

Amendment by Pub. L. 107-147 effective as if included in the provisions of the Community Renewal Tax Relief Act of 2000 [H.R. 5662, as enacted by Pub. L. 106-554], to which such amendment relates, see section 412(e) of Pub. L. 107-147, set out as a note under section 151 of this title.

EFFECTIVE AND TERMINATION DATES OF 2001 AMENDMENT

Amendment by Pub. L. 107-16 applicable to payments made in taxable years beginning after Dec. 31, 2001, see section 431(d) of Pub. L. 107-16, set out as a note under section 62 of this title.

Amendment by Pub. L. 107-16 inapplicable to taxable, plan, or limitation years beginning after Dec. 31, 2010, and the Internal Revenue Code of 1986 to be applied and administered to such years as if such amendment had never been enacted, see section 901 of Pub. L. 107-16, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105-277 effective as if included in the provision of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 4003(l) of Pub. L. 105-277, set out as a note under section 86 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Section 1704(d)(2) of Pub. L. 104-188 provided that: “The amendment made by paragraph (1) [amending this

section] shall apply to taxable years beginning after December 31, 1986.”

Section 1704(e)(2) of Pub. L. 104-188 provided that: “The amendment made by paragraph (1) [amending this section] shall apply to taxable years beginning after December 31, 1986.”

Amendment by section 1807(c)(4) of Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1996, see section 1807(e) of Pub. L. 104-188, set out as an Effective Date note under section 23 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Section 13143(c) of Pub. L. 103-66 provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 1993.”

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by section 11813(b)(16) of Pub. L. 101-508 applicable to property placed in service after Dec. 31, 1990, but not applicable to any transition property (as defined in section 49(e) of this title), any property with respect to which qualified progress expenditures were previously taken into account under section 46(d) of this title, and any property described in section 46(b)(2)(C) of this title, as such sections were in effect on Nov. 4, 1990, see section 11813(c) of Pub. L. 101-508, set out as a note under section 45K of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Section 7109(b) of Pub. L. 101-239 provided that: “(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section [amending this section] shall apply to property placed in service after December 31, 1989, in taxable years ending after such date.

“(2) SPECIAL RULE WHERE INTEREST HELD IN PASS-THRU ENTITY.—In the case of a taxpayer who holds an indirect interest in property described in paragraph (1), the amendments made by this section shall apply only if such interest is acquired after December 31, 1989.”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by section 1005(a)(1)-(9), (11), (12) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

Amendment by section 2004(g) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provisions of the Revenue Act of 1987, Pub. L. 100-203, title X, to which such amendment relates, see section 2004(u) of Pub. L. 100-647, set out as a note under section 56 of this title.

Amendment by section 6009(c)(3) of Pub. L. 100-647 applicable to taxable years beginning after Dec. 31, 1989, see section 6009(d) of Pub. L. 100-647, set out as a note under section 86 of this title.

EFFECTIVE DATE OF 1987 AMENDMENT

Amendment by Pub. L. 100-203 effective as if included in the amendments made by section 501 of the Tax Reform Act of 1986, Pub. L. 99-514, see section 10212(c) of Pub. L. 100-203, set out as a note under section 58 of this title.

EFFECTIVE DATE

Section 501(c) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, §1005(a)(10), title IV, §4003(b)(2), Nov. 10, 1988, 102 Stat. 3388, 3644, provided that:

“(1) IN GENERAL.—The amendments made by this section [enacting this section] shall apply to taxable years beginning after December 31, 1986.

“(2) SPECIAL RULE FOR CARRYOVERS.—The amendments made by this section shall not apply to any loss, deduction, or credit carried to a taxable year beginning after December 31, 1986, from a taxable year beginning before January 1, 1987.

“(3) Repealed. Pub. L. 100-647, title IV, §4003(b)(2), Nov. 10, 1988, 102 Stat. 3644.]

“(4) INCOME FROM SALES OF PASSIVE ACTIVITIES IN TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1987.—If—

“(A) gain is recognized in a taxable year beginning after December 31, 1986, from a sale or exchange of an interest in an activity in a taxable year beginning before January 1, 1987, and

“(B) such gain would have been treated as gain from a passive activity had section 469 of the Internal Revenue Code of 1986 (as added by this section) been in effect for the taxable year in which the sale or exchange occurred and for all succeeding taxable years, then such gain shall be treated as gain from a passive activity for purposes of such section.”

SAVINGS PROVISION

For provisions that nothing in amendment by section 11813(b)(16) of Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

AMOUNTS ATTRIBUTABLE TO ACTIVITIES SUBJECT TO LIMITATIONS UNDER SECTION 469 TREATED AS DEDUCTION ALLOCABLE TO SUCH ACTIVITY

Section 1005(c)(11) of Pub. L. 100-647 provided that: “If—

“(A) any amount was disallowed as a deduction under section 163(d) of the Internal Revenue Code of 1954 [now 1986] (as in effect on the day before the date of the enactment of the Reform Act [Oct. 22, 1986]).

“(B) such amount would (but for this paragraph) be treated as investment interest paid or accrued by the taxpayer in the taxpayer’s first taxable year beginning after December 31, 1986, and

“(C) the taxpayer makes an election under this paragraph at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe,

to the extent such amount is attributable to an activity subject to the limitations of section 469 of the 1986 Code, such amount shall not be treated as investment interest but shall be treated as a deduction allocable to such activity for such first taxable year. Subsection (m) of section 469 of the 1986 Code and section 501(c)(2) of the Reform Act [Pub. L. 99-514, set out as an Effective Date note above] shall not apply to any amount so treated.”

TRANSITIONAL RULE FOR LOW-INCOME HOUSING

Section 502 of Pub. L. 99-514, as amended by Pub. L. 99-509, title VIII, §8073(a), Oct. 21, 1986, 100 Stat. 1965; Pub. L. 100-647, title I, §1005(b), Nov. 10, 1988, 102 Stat. 3389, provided that:

“(a) GENERAL RULE.—Any loss sustained by a qualified investor with respect to an interest in a qualified low-income housing project for any taxable year in the relief period shall not be treated as a loss from a passive activity for purposes of section 469 of the Internal Revenue Code of 1986.

“(b) RELIEF PERIOD.—For purposes of subsection (a), the term ‘relief period’ means the period beginning with the taxable year in which the investor made his initial investment in the qualified low-income housing project and ending with whichever of the following is the earliest—

“(1) the 6th taxable year after the taxable year in which the investor made his initial investment,

“(2) the 1st taxable year after the taxable year in which the investor is obligated to make his last investment, or

“(3) the taxable year preceding the 1st taxable year for which such project ceased to be a qualified low-income housing project.

“(c) QUALIFIED LOW-INCOME HOUSING PROJECT.—For purposes of this section, the term ‘qualified low-income housing project’ means any project if—

“(1) such project meets the requirements of clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B) [of the Internal Revenue Code of 1986] as of the date placed in service and for each taxable year thereafter which begins after 1986 and for which a passive loss may be allowable with respect to such project.

“(2) the operator certifies to the Secretary of the Treasury or his delegate that such project met the requirements of paragraph (1) on the date of the enactment of this Act [Oct. 22, 1986] (or, if later, when placed in service) and annually thereafter,

“(3) such project is constructed or acquired pursuant to a binding written contract entered into on or before August 16, 1986, and

“(4) such project is placed in service before January 1, 1989.

“(d) **QUALIFIED INVESTOR.**—For purposes of this section—

“(1) **IN GENERAL.**—The term ‘qualified investor’ means any natural person who holds (directly or through 1 or more entities) an interest in a qualified low-income housing project—

“(A) if—

“(i) in the case of a project placed in service on or before August 16, 1986, such person held an interest in such project on August 16, 1986, and such person made his initial investment after December 31, 1983, or

“(ii) in the case of a project placed in service after August 16, 1986, such person made his initial investment after December 31, 1983, and such person held an interest in such project on December 31, 1986, and

“(B) if such investor is required to make payments after December 31, 1986, of 50 percent or more of the total original obligated investment for such interest.

For purposes of subparagraph (A), a person shall be treated as holding an interest on August 16, 1986, or December 31, 1986, if on such date such person had a binding contract to acquire such interest.

“(2) **TREATMENT OF ESTATES.**—The estate of a decedent shall succeed to the treatment under this section of the decedent but only with respect to the 1st 2 taxable years of such estate ending after the date of the decedent's death.

“(3) **SPECIAL RULE FOR CERTAIN PARTNERSHIPS.**—In the case of any property which is held by a partnership—

“(A) which placed such property in service on or after December 31, 1985, and before August 17, 1986, and continuously held such property through the close of the taxable year for which the determination is being made, and

“(B) which was not treated as a new partnership or as terminated at any time on or after the date on which such property was placed in service and through the close of the taxable year for which the determination is being made,

paragraph (1)(A)(i) shall be applied by substituting ‘December 31, 1988’ for ‘August 16, 1986’ the 2nd place it appears.

“(4) **SPECIAL RULE FOR CERTAIN RURAL HOUSING.**—In the case of any interest in a qualified low-income housing project which—

“(A) is assisted under section 515 of the Housing Act of 1949 [42 U.S.C. 1485] (relating to the Farmers' Home Administration Program), and

“(B) is located in a town with a population of less than 10,000 and which is not part of a metropolitan statistical area,

paragraph (1)(B) shall be applied by substituting ‘35 percent’ for ‘50 percent’ and subsection (b)(1) shall be applied by substituting ‘5th taxable year’ for ‘6th taxable year’. The preceding sentence shall not apply to any interest unless, on December 31, 1986, at least one-half of the number of payments required with respect to such interest remain to be paid.

“(e) **SPECIAL RULES.**—

“(1) **WHERE MORE THAN 1 BUILDING IN PROJECT.**—If there is more than 1 building in any project, the de-

termination of when such project is placed in service shall be based on when the 1st building in such project is placed in service.

“(2) **ONLY CASH AND OTHER PROPERTY TAKEN INTO ACCOUNT.**—In determining the amount any person invests in (or is obligated to invest in) any interest, only cash and other property shall be taken into account.

“(3) **COORDINATION WITH CREDIT.**—No low-income housing credit shall be determined under section 42 of the Internal Revenue Code of 1986 with respect to any project with respect to which any person has been allowed any benefit under this section.”

[Section 8073(b) of Pub. L. 99-509 provided that: “The amendment made by subsection (a) [amending section 502 of Pub. L. 99-514, set out above] shall take effect as if included in section 502 of the Tax Reform Act of 1986 on the date of its enactment [Oct. 22, 1986].”]

§ 470. Limitation on deductions allocable to property used by governments or other tax-exempt entities

(a) Limitation on losses

Except as otherwise provided in this section, a tax-exempt use loss for any taxable year shall not be allowed.

(b) Disallowed loss carried to next year

Any tax-exempt use loss with respect to any tax-exempt use property which is disallowed under subsection (a) for any taxable year shall be treated as a deduction with respect to such property in the next taxable year.

(c) Definitions

For purposes of this section—

(1) Tax-exempt use loss

The term “tax-exempt use loss” means, with respect to any taxable year, the amount (if any) by which—

(A) the sum of—

(i) the aggregate deductions (other than interest) directly allocable to a tax-exempt use property, plus

(ii) the aggregate deductions for interest properly allocable to such property, exceed

(B) the aggregate income from such property.

(2) Tax-exempt use property

(A) In general

The term “tax-exempt use property” has the meaning given to such term by section 168(h), except that such section shall be applied—

(i) without regard to paragraphs (1)(C) and (3) thereof, and

(ii) as if section 197 intangible property (as defined in section 197), and property described in paragraph (1)(B) or (2) of section 167(f), were tangible property.

(B) Exception for partnerships

Such term shall not include any property which would (but for this subparagraph) be tax-exempt use property solely by reason of section 168(h)(6).

(C) Cross reference

For treatment of partnerships as leases to which section 168(h) applies, see section 7701(e).

(d) Exception for certain leases

This section shall not apply to any lease of property which meets the requirements of all of the following paragraphs:

(1) Availability of funds**(A) In general**

A lease of property meets the requirements of this paragraph if (at all times during the lease term) not more than an allowable amount of funds are—

- (i) subject to any arrangement referred to in subparagraph (B), or
- (ii) set aside or expected to be set aside,

to or for the benefit of the lessor or any lender, or to or for the benefit of the lessee to satisfy the lessee's obligations or options under the lease. For purposes of clause (ii), funds shall be treated as set aside or expected to be set aside only if a reasonable person would conclude, based on the facts and circumstances, that such funds are set aside or expected to be set aside.

(B) Arrangements

The arrangements referred to in this subparagraph include a defeasance arrangement, a loan by the lessee to the lessor or any lender, a deposit arrangement, a letter of credit collateralized with cash or cash equivalents, a payment undertaking agreement, prepaid rent (within the meaning of the regulations under section 467), a sinking fund arrangement, a guaranteed investment contract, financial guaranty insurance, and any similar arrangement (whether or not such arrangement provides credit support).

(C) Allowable amount**(i) In general**

Except as otherwise provided in this subparagraph, the term "allowable amount" means an amount equal to 20 percent of the lessor's adjusted basis in the property at the time the lease is entered into.

(ii) Higher amount permitted in certain cases

To the extent provided in regulations, a higher percentage shall be permitted under clause (i) where necessary because of the credit-worthiness of the lessee. In no event may such regulations permit a percentage of more than 50 percent.

(iii) Option to purchase

If under the lease the lessee has the option to purchase the property for a fixed price or for other than the fair market value of the property (determined at the time of exercise), the allowable amount at the time such option may be exercised may not exceed 50 percent of the price at which such option may be exercised.

(iv) No allowable amount for certain arrangements

The allowable amount shall be zero with respect to any arrangement which involves—

- (I) a loan from the lessee to the lessor or a lender,
- (II) any deposit received, letter of credit issued, or payment undertaking agreement entered into by a lender otherwise involved in the transaction, or

(III) in the case of a transaction which involves a lender, any credit support made available to the lessor in which any such lender does not have a claim that is senior to the lessor.

For purposes of subclause (I), the term "loan" shall not include any amount treated as a loan under section 467 with respect to a section 467 rental agreement.

(2) Lessor must make substantial equity investment**(A) In general**

A lease of property meets the requirements of this paragraph if—

- (i) the lessor—
 - (I) has at the time the lease is entered into an unconditional at-risk equity investment (as determined by the Secretary) in the property of at least 20 percent of the lessor's adjusted basis in the property as of that time, and
 - (II) maintains such investment throughout the term of the lease, and
- (ii) the fair market value of the property at the end of the lease term is reasonably expected to be equal to at least 20 percent of such basis.

(B) Risk of loss

For purposes of clause (ii),¹ the fair market value at the end of the lease term shall be reduced to the extent that a person other than the lessor bears a risk of loss in the value of the property.

(C) Paragraph not to apply to short-term leases

This paragraph shall not apply to any lease with a lease term of 5 years or less.

(3) Lessee may not bear more than minimal risk of loss**(A) In general**

A lease of property meets the requirements of this paragraph if there is no arrangement under which the lessee bears—

- (i) any portion of the loss that would occur if the fair market value of the leased property were 25 percent less than its reasonably expected fair market value at the time the lease is terminated, or
- (ii) more than 50 percent of the loss that would occur if the fair market value of the leased property at the time the lease is terminated were zero.

(B) Exception

The Secretary may by regulations provide that the requirements of this paragraph are not met where the lessee bears more than a minimal risk of loss.

(C) Paragraph not to apply to short-term leases

This paragraph shall not apply to any lease with a lease term of 5 years or less.

(4) Property with more than 7-year class life

In the case of a lease—

¹ So in original. Probably should be "subparagraph (A)(ii)".

(A) of property with a class life (as defined in section 168(i)(1)) of more than 7 years, other than fixed-wing aircraft and vessels, and

(B) under which the lessee has the option to purchase the property,

the lease meets the requirements of this paragraph only if the purchase price under the option equals the fair market value of the property (determined at the time of exercise).

(e) Special rules

(1) Treatment of former tax-exempt use property

(A) In general

In the case of any former tax-exempt use property—

(i) any deduction allowable under subsection (b) with respect to such property for any taxable year shall be allowed only to the extent of any net income (without regard to such deduction) from such property for such taxable year, and

(ii) any portion of such unused deduction remaining after application of clause (i) shall be treated as a deduction allowable under subsection (b) with respect to such property in the next taxable year.

(B) Former tax-exempt use property

For purposes of this subsection, the term “former tax-exempt use property” means any property which—

(i) is not tax-exempt use property for the taxable year, but

(ii) was tax-exempt use property for any prior taxable year.

(2) Disposition of entire interest in property

If during the taxable year a taxpayer disposes of the taxpayer’s entire interest in tax-exempt use property (or former tax-exempt use property), rules similar to the rules of section 469(g) shall apply for purposes of this section.

(3) Coordination with section 469

This section shall be applied before the application of section 469.

(4) Coordination with sections 1031 and 1033

(A) In general

Sections 1031(a) and 1033(a) shall not apply if—

(i) the exchanged or converted property is tax-exempt use property subject to a lease which was entered into before March 13, 2004, and which would not have met the requirements of subsection (d) had such requirements been in effect when the lease was entered into, or

(ii) the replacement property is tax-exempt use property subject to a lease which does not meet the requirements of subsection (d).

(B) Adjusted basis

In the case of property acquired by the lessor in a transaction to which section 1031 or 1033 applies, the adjusted basis of such property for purposes of this section shall be equal to the lesser of—

(i) the fair market value of the property as of the beginning of the lease term, or

(ii) the amount which would be the lessor’s adjusted basis if such sections did not apply to such transaction.

(f) Other definitions

For purposes of this section—

(1) Related parties

The terms “lessor”, “lessee”, and “lender” each include any related party (within the meaning of section 197(f)(9)(C)(i)).

(2) Lease term

The term “lease term” has the meaning given to such term by section 168(i)(3).

(3) Lender

The term “lender” means, with respect to any lease, a person that makes a loan to the lessor which is secured (or economically similar to being secured) by the lease or the leased property.

(4) Loan

The term “loan” includes any similar arrangement.

(g) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations which—

(1) allow in appropriate cases the aggregation of property subject to the same lease, and

(2) provide for the determination of the allocation of interest expense for purposes of this section.

(Added Pub. L. 108-357, title VIII, §848(a), Oct. 22, 2004, 118 Stat. 1602; amended Pub. L. 110-172, §7(c), Dec. 29, 2007, 121 Stat. 2482.)

AMENDMENTS

2007—Subsec. (c)(2). Pub. L. 110-172, §7(c)(1), reenacted heading without change and amended text generally. Prior to amendment, text read as follows: “The term ‘tax-exempt use property’ has the meaning given to such term by section 168(h), except that such section shall be applied—

“(A) without regard to paragraphs (1)(C) and (3) thereof, and

“(B) as if property described in—

“(i) section 167(f)(1)(B),

“(ii) section 167(f)(2), and

“(iii) section 197 intangible,

were tangible property.

Such term shall not include property which would (but for this sentence) be tax-exempt use property solely by reason of section 168(h)(6) if any credit is allowable under section 42 or 47 with respect to such property.”

Subsec. (d)(1)(A). Pub. L. 110-172, §7(c)(2), in introductory provisions, substituted “(at all times during the lease term)” for “(at any time during the lease term)”.

EFFECTIVE DATE OF 2007 AMENDMENT

Amendment by Pub. L. 110-172 effective as if included in the provision of the American Jobs Creation Act of 2004, Pub. L. 108-357, to which such amendment relates, see section 7(e) of Pub. L. 110-172, set out as a note under section 1092 of this title.

EFFECTIVE DATE

Pub. L. 108-357, title VIII, §849, Oct. 22, 2004, 118 Stat. 1606, as amended by Pub. L. 109-135, title IV, §403(ff), Dec. 21, 2005, 119 Stat. 2631, provided that:

“(a) IN GENERAL.—Except as provided in this section, the amendments made by this part [part III (§§847–849) of subtitle B of title VIII of Pub. L. 108–357, enacting this section and amending sections 167, 168, and 197 of this title] shall apply to leases entered into after March 12, 2004, and in the case of property treated as tax-exempt use property other than by reason of a lease, to property acquired after March 12, 2004.

“(b) EXCEPTION.—

“(1) IN GENERAL.—The amendments made by this part shall not apply to qualified transportation property.

“(2) QUALIFIED TRANSPORTATION PROPERTY.—For purposes of paragraph (1), the term ‘qualified transportation property’ means domestic property subject to a lease with respect to which a formal application—

“(A) was submitted for approval to the Federal Transit Administration (an agency of the Department of Transportation) after June 30, 2003, and before March 13, 2004.

“(B) is approved by the Federal Transit Administration before January 1, 2006, and

“(C) includes a description of such property and the value of such property.

“(3) EXCHANGES AND CONVERSION OF TAX-EXEMPT USE PROPERTY.—Section 470(e)(4) of the Internal Revenue Code of 1986, as added by section 848, shall apply to property exchanged or converted after the date of the enactment of this Act [Oct. 22, 2004].

“(4) INTANGIBLES AND INDIAN TRIBAL GOVERNMENTS.—The amendments made subsections (b)(2), (b)(3), and (e) of section 847 [amending sections 167, 168, and 197 of this title], and the treatment of property described in clauses (ii) and (iii) of section 470(c)(2)(B) of the Internal Revenue Code of 1986 (as added by section 848) as tangible property, shall apply to leases entered into after October 3, 2004.”

SUBPART D—INVENTORIES

Sec.	
471.	General rule for inventories.
472.	Last-in, first-out inventories.
473.	Qualified liquidations of LIFO inventories.
474.	Simplified dollar-value LIFO method for certain small businesses.
475.	Mark to market accounting method for dealers in securities.

AMENDMENTS

1993—Pub. L. 103–66, title XIII, §13223(b)(2), Aug. 10, 1993, 107 Stat. 484, added item 475.

1986—Pub. L. 99–514, title VIII, §802(b), Oct. 22, 1986, 100 Stat. 2350, substituted “Simplified dollar-value LIFO method for certain small businesses” for “Election by certain small businesses to use one inventory pool” in item 474.

1981—Pub. L. 97–34, title II, §237(b), Aug. 13, 1981, 95 Stat. 253, added item 474.

1980—Pub. L. 96–223, title IV, §403(a)(2), Apr. 2, 1980, 94 Stat. 304, added item 473.

§ 471. General rule for inventories

(a) General rule

Whenever in the opinion of the Secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(b) Estimates of inventory shrinkage permitted

A method of determining inventories shall not be treated as failing to clearly reflect income solely because it utilizes estimates of inventory

shrinkage that are confirmed by a physical count only after the last day of the taxable year if—

(1) the taxpayer normally does a physical count of inventories at each location on a regular and consistent basis, and

(2) the taxpayer makes proper adjustments to such inventories and to its estimating methods to the extent such estimates are greater than or less than the actual shrinkage.

(c) Cross reference

For rules relating to capitalization of direct and indirect costs of property, see section 263A.

(Aug. 16, 1954, ch. 736, 68A Stat. 159; Pub. L. 94–455, title XIX, §1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub. L. 99–514, title VIII, §803(b)(4), Oct. 22, 1986, 100 Stat. 2356; Pub. L. 105–34, title IX, §961(a), Aug. 5, 1997, 111 Stat. 891.)

AMENDMENTS

1997—Subsecs. (b), (c). Pub. L. 105–34 added subsec. (b) and redesignated former subsec. (b) as (c).

1986—Pub. L. 99–514 designated existing provisions as subsec. (a) and added subsec. (b).

1976—Pub. L. 94–455 struck out “or his delegate” after “Secretary” wherever appearing.

EFFECTIVE DATE OF 1997 AMENDMENT

Section 961(b)(1) of Pub. L. 105–34 provided that: “The amendment made by this section [amending this section] shall apply to taxable years ending after the date of the enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1986 AMENDMENT

If any interest costs incurred after Dec. 31, 1986, are attributable to costs incurred before Jan. 1, 1987, the amendment by Pub. L. 99–514 is applicable to such interest costs only to the extent such interest costs are attributable to costs which were required to be capitalized under section 263 of the Internal Revenue Code of 1954 and which would have been taken into account in applying section 189 of the Internal Revenue Code of 1954 (as in effect before its repeal by section 803 of Pub. L. 99–514) or, if applicable, section 266 of such Code, see section 7831(d)(2) of Pub. L. 101–239, set out as an Effective Date note under section 263A of this title.

Amendment by Pub. L. 99–514 applicable to costs incurred after Dec. 31, 1986, in taxable years ending after such date, except as otherwise provided, see section 803(d) of Pub. L. 99–514, set out as an Effective Date note under section 263A of this title.

COORDINATION WITH SECTION 481

Section 961(b)(2) of Pub. L. 105–34 provided that: “In the case of any taxpayer permitted by this section [amending this section and enacting provisions set out as a note above] to change its method of accounting to a permissible method for any taxable year—

“(A) such changes shall be treated as initiated by the taxpayer,

“(B) such changes shall be treated as made with the consent of the Secretary of the Treasury, and

“(C) the period for taking into account the adjustments under section 481 [26 U.S.C. 481] by reason of such change shall be 4 years.”

STUDY OF ACCOUNTING METHODS FOR INVENTORY; REPORT NOT LATER THAN DECEMBER 31, 1982

Pub. L. 97–34, title II, §238, Aug. 13, 1981, 95 Stat. 254, directed Secretary of the Treasury to conduct a study of methods of tax accounting for inventory with a view towards development of simplified methods and to report to Congress, not later than Dec. 31, 1982, prior to repeal by Pub. L. 100–647, title VI, §6252(a)(2), Nov. 10, 1988, 102 Stat. 3752.