10.0 AT-RISK LIMITATIONS

10.1 GENERAL OVERVIEW – IRC SECTION 465 AND R&TC SECTION 17551

A shareholder's ability to deduct pass-through losses from an S corporation is limited by various provisions.

First, the shareholder can only deduct losses to the extent that the shareholder has sufficient basis in the stock and debt of the S corporation. (IRC Section 1366(d)(1))

Second, the shareholder can only deduct losses to the extent that the shareholder has a sufficient amount at-risk with regard to the shareholder's investment in the S corporation. (IRC Section 465)

Oftentimes, a shareholder's stock and debt basis will be the same as the shareholder's amount at-risk; however, the shareholder's amount at-risk can be lower than the shareholder's stock and debt bases due to the fact that some transactions that give rise to additional basis do not provide an addition to the shareholder's amount at-risk. (IRC Section 465(b)(3) and (4))

R&TC Section 17551 generally conforms to IRC Section 465.

10.2 AMOUNT AT-RISK

An S corporation shareholder is considered at risk for the sum of the following (IRC Section 465(b)(1)):

- The amount of money and the adjusted basis of other property contributed by the shareholder to the activity; and
- Amounts borrowed with respect to such activity (as determined under IRC Section 465(b)(2)).

The initial amount the taxpayer is at-risk in the activity is the taxpayer's initial basis as modified by disregarding amounts described in Section 465(b)(3) or (4) (relating generally to amounts protected against loss or borrowed from related persons). (Treas. Reg. Section 7.465-2(a))

10.3 CONTRIBUTIONS OF CASH OR OTHER PROPERTY

IRC Section 465(b)(1)(A) provides that the taxpayer, including a shareholder of an S corporation, is at-risk for an activity with respect to the amount of money and the adjusted basis of "other property" contributed by the taxpayer to the activity. Proposed Reg. Section 1.465-22(a) elaborates by providing that a taxpayer's amount at-risk in an activity will be increased by the "personal funds" the taxpayer contributes to the activity. Proposed Reg. Section 1.465-9(f) provides that "personal funds" means funds that satisfy all of the following conditions:

- They are owned by the taxpayer;
- They are not acquired through borrowing; and
- They have a basis equal to their fair market value.

Personal funds do not necessarily include amounts an S corporation shareholder borrows and then contributes or lends to the S corporation. An S corporation shareholder is only considered at-risk with respect to borrowed funds if the S corporation shareholder is personally liable for the repayment of the borrowed funds or has pledged property, other than property used by the S corporation, as security for the borrowed funds. (IRC Section 465(b)(2))

Proposed Reg. Section1.465-23(a)(2) sets forth rules for determining the increase in a taxpayer's at-risk amount where the taxpayer contributes encumbered property to an activity. Where a taxpayer contributes property subject to liabilities for which the taxpayer is personally liable (recourse liabilities), the taxpayer's at-risk amount is increased by the adjusted basis of the contributed property just as if the contributed property were unencumbered. (Proposed Reg. Section 1.465-23(a)(2)) Where the contributed property is subject to a nonrecourse liability, the taxpayer's amount at-risk is increased by the taxpayer's adjusted basis in such property and then the taxpayer's amount at-risk is decreased by the amount of the nonrecourse liability. (Proposed Reg. Section 1.465-23(a)(2)(ii)) For purposes of determining the increase in the taxpayer's at-risk amount caused by property contributions, Proposed Reg. Section 1.465-23(b)(1) requires use of the adjusted basis of the contributed property that would have been used in determining the loss if the contributed property were sold immediately after being contributed to the activity.

10.4 CONTRIBUTIONS OF CASH OR OTHER PROPERTY PURCHASED WITH BORROWED FUNDS

As mentioned above, where an S corporation shareholder contributes or loans borrowed money to an S corporation or contributes unencumbered property purchased with borrowed funds, the shareholder's at-risk amount will increase only to the extent such shareholder is at-risk with respect to such borrowed amount. IRC Section 465(b)(1)(B) provides that a taxpayer will be at-risk with respect to amounts borrowed for use in an activity to the extent provided in IRC §465(b)(2). This section sets forth rules for determining a taxpayer's at-risk amount for borrowed funds, depending on whether the loan is recourse or nonrecourse.

10.4.1 Recourse Financing

A taxpayer is at-risk with respect to amounts borrowed for use in an activity to the extent personally liable for repayment of the loan. (IRC Section 465(b)(2)(A)) Thus, where an S corporation shareholder borrows funds on a recourse basis, such shareholder generally will be at-risk for the loan proceeds thereafter actually contributed or loaned to the S corporation.

10.4.2 Non-Recourse Financing

In the case of amounts borrowed on a nonrecourse basis for use in an activity, the taxpayer will be at-risk where the taxpayer has pledged property, other than property used in such activity, as security for the amounts borrowed to the extent of the "net fair market value" of the taxpayer's interest in the pledged property. (IRC Section 465(b)(2)(B))

For this purpose, if a shareholder pledged the stock in the S corporation to borrow funds and the funds are then used in the S corporation's activity, the S corporation stock is considered property used in the activity. (Refer to the last sentence of IRC Section 465(b)(2) and Proposed Reg. Section 1.465-25(b)(1), which applies this rule to partnerships.) Thus, an S corporation shareholder is not at-risk for amounts contributed or loaned to an S corporation obtained through a nonrecourse loan secured only by the shareholder's S corporation stock.

Example A

Sam and Joel form an S corporation.

Sam contributes $100,000 of his personal funds in exchange for 50% of the stock.

Joel borrows $100,000 on a nonrecourse basis secured only by a pledge of the S corporation stock. Joel contributes the $100,000 in exchange for 50% of the stock.

Sam's shareholder basis at the beginning of Year 1 is $100,000 and his at-risk-basis is $100,000.

Joel's shareholder basis at the beginning of Year 1 is $100,000 and his at-risk basis is $0.

Assuming the S corporation reported an ordinary loss of ($150,000), Sam and Joel would report the following:

	Sam Recognized	Joel Recognized	Joel Suspended
1st Loss Limitation Level – Shareholder Basis			
Beginning stock basis	$100,000	$100,000	
Ordinary loss	-75,000	-75,000	
Ending stock basis	25,000	25,000	
2nd Loss Limitation Level – At-Risk			
Beginning at-risk basis	$100,000	$ 0	
Ordinary loss	-75,000	0	-$75,000
Ending at-risk basis	$ 25,000	$ 0	

Sam is allowed to recognize ($75,000) ordinary loss after applying shareholder stock basis and at-risk limitations.

Joel is allowed ($75,000) ordinary loss after application of the shareholder stock basis, but he cannot recognize any of the loss at the at-risk level.

10.4.3 Qualified Nonrecourse Financing

Although an S corporation shareholder will generally not be at-risk for amounts contributed or loaned to the corporation obtained through nonrecourse financing secured only by property used in the activity, a limited exception is available under IRC Section 465(b)(6) for "qualified nonrecourse financing."

Under this rule, a taxpayer is at-risk with respect to qualified nonrecourse financing that is secured by real property used in the activity of holding real property. IRC Section 465(b)(6)(B) provides that qualified nonrecourse financing is any financing:

- Borrowed by the taxpayer with respect to the activity of holding real property;
- Borrowed by the taxpayer from a "qualified person" (or from a federal, state, or local government or instrumentality thereof, or guaranteed by such an entity);

- With respect to which no person is personally liable for repayment; and
- That is not convertible debt.

A "qualified person" is a person who is actively and regularly engaged in the business of lending money and not:

- A related person with respect to the taxpayer, except where the financing from such related person is commercially reasonable and on substantially the same terms as loans involving unrelated persons.
- A person from whom the taxpayer acquired the property (or a related person to such person).
- A person who receives a fee with respect to the taxpayer's investment in the property (or a related person to such person). (IRC Section 465(b)(6)(d) and Section49(a)(1)(D)(iv))

Thus, a taxpayer is at-risk for amounts borrowed on a nonrecourse basis that are secured by and used in the activity of holding real property if the loan is made by a person actively and regularly engaged in the business of lending money (including related persons, where the financing is commercially reasonable and on substantially the same terms as loans involving unrelated persons).

In the S corporation context, this provision will have limited applicability since shareholders of an S corporation are not permitted to increase their stock or debt basis by corporate-level indebtedness. Generally, IRC Section 1366(d)(1) limits the amount of flow-through losses to the extent of basis in indebtedness of the S corporation to the shareholder.

Where, however, qualified nonrecourse financing is structured as a "back-to-back" loan or capital contribution between the shareholder (as the primary debtor to the qualified lender) and the S corporation; the shareholder should be able to take advantage of this provision. Thus, if an S corporation shareholder borrows money on a nonrecourse basis from a qualified lender secured only by real property used by the S corporation in real property activities, and the shareholder thereafter contributes or loans such funds to the S corporation, such shareholder's at-risk amount and basis amount will be increased by the loan proceeds contributed or loaned to the S corporation. In Example A within Section 10.4, if the S corporation used the capital contributions made to it to purchase real property to be used in the activity of holding real property, and Joel had obtained his loan from a qualified lender and secured such loan by the S corporation's real property rather than by a pledge of his S corporation stock, Joel's at-risk amount would increase to $100,000, the same as his basis in his S corporation stock.

For more details on how to increase debt basis, see Section 9.0 of this Manual.

10.5 AMOUNTS BORROWED FROM PERSONS HAVING AN INTEREST IN THE ACTIVITY

An S corporation shareholder is generally not at-risk with regard to funds borrowed from a person who has an interest in the S corporation or a person related to a person having an interest in the S corporation. (IRC Section465(b)(3)(A))

However, if the lender's interest in the S corporation is only an interest as a creditor, the S corporation shareholder will be considered at-risk with regard to the borrowed funds. (IRC Section 465(b)(3)(B)(i)) Therefore, an S corporation shareholder will not be considered at-risk with regard to funds borrowed from other shareholders because the other shareholders have an interest in the S corporation that is not merely an interest as a creditor.

In the case of loans where the borrower is personally liable (recourse loans), Treas. Reg. Section 1.465-8(b)(1) provides that the lender will have an interest in the activity other than as a creditor if the lender has either a capital interest in the activity (a shareholder of the S corporation) or an interest in the net profits of the activity.

Under Treas. Reg. Section 1.465-8(b)(2), a capital interest in an activity is an interest in the assets of the activity that is distributable to the owner of the interest upon liquidation of the activity. Thus, an S corporation shareholder has a capital interest in the activities conducted by the S corporation.

Reg. Section 1.465-8(b)(3) provides that a person has an interest in the net profits of an S corporation if any part of the person's compensation is determined with regard to the net profits of the S corporation (i.e., employees and independent contractors), regardless of whether such person holds any of the incidents of ownership with respect to the S corporation.

In the case of nonrecourse loans secured by assets having a readily ascertainable FMV, the lender will be a person with an interest in the activity other than as a creditor only if the lender has either a capital interest in the activity or an interest in the net profits of the activity. (Treas. Reg. Section 1.465-8(c)(1)) An interest in the gross receipts of an S corporation is not a net profits interest for this purpose. (Treas Reg. Section1.465-8(b)(4), Example (2))

In the case of nonrecourse loans secured by assets not having a readily ascertainable FMV, however, the lender will be a person with an interest in the activity other than as a creditor if the lender stands to receive financial gain (1) other than interest from the activity (i.e. - compensation for services rendered in connection with the organization or operation of the activity) or (2) from the sale of an interest in the activity. (Treas. Reg. Section 1.465-8(d)(1))

Thus, a promoter who organizes the activity or solicits potential investors in the activity will generally have an interest in the activity other than as a creditor with respect to nonrecourse loans secured only by property not having a readily ascertainable FMV.

10.5.1 Limited Application

Although the previous section discussed the related party rules contained in IRC Section 465(b)(3) as if they applied to all S corporation shareholders, these rules do not automatically apply to S corporation shareholders. The related party rules contained in IRC Section 465(b)(3) only apply to S corporation shareholders to the extent the S corporation is involved in the following five activities listed in IRC §465(c)(1):

- Holding, producing, or distributing motion picture films or videotapes;
- Farming (as defined in IRC Section 464(e));
- Leasing any IRC Section 1245 property (as defined in IRC Section 1245(a)(3));
- Exploring for, or exploiting, oil, and gas resources as a trade or business or for the production of income; or
- Exploring for, or exploiting, geothermal deposits (as defined in IRC Section 613(e)(2)).

The reason for this limitation is statutory. When IRC Section 465 was originally enacted in 1976, it only applied to the five activities listed above. (See P.L. 94-455.) IRC Section 465(c)(3) was added to the Code in 1978 and thereby extended the application of IRC Section 465 to include activities engaged in by the taxpayer in carrying on a trade or business or for the production of income, which would include investments in an S corporation. (See P.L. 95-600.) However, when Congress enacted IRC Section 465(c)(3), Congress limited the application of the related party rules to these newly covered activities by enacting IRC Section 465(c)(3)(D), which provides that the related party rules will only apply to the new activities to the extent provided by the regulations. Unfortunately, the Treasury has never promulgated the regulation required by Congress and in 1990 the Tax Court held that the related party rules could not be applied to the newly covered activities until the IRS promulgates such regulations. (See Alexander v. Commissioner (1990) 95 T.C. 467.)

If an auditor encounters a situation where an S corporation shareholder would not be entitled to increase his or her at-risk amount if the related party rules of IRC Section 465(b)(3) were applied, but the rules cannot be applied due to the fact that the S corporation is not involved in one of the five activities discussed above, the auditor should review the transaction with regard to IRC Section 465(b)(4). Under IRC Section 465(b)(4), "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."

10.6 CORPORATE-LEVEL INDEBTEDNESS

In the case of S corporations, whether the at-risk rule will limit the amount of losses that can be reported by each shareholder is determined at the shareholder level. (IRC Section 465(a)(1)(A)). Before the 1984 TRA, there was some uncertainty as to whether the rule applied at the S corporation level. However, the 1984 TRA clarified Section 465(a)(1)(B) to apply only to C corporations; therefore, it is now clear under the current statute that an S corporation is not subject to the at-risk rules at the corporate level. (1984 TRA, Section 721(x)(2)).

An S corporation shareholder's personal guarantee for a loan made directly to the S corporation does not increase the S corporation shareholder's amount at-risk. (Proposed Reg. §1.465-6(d)) However, if the S corporation shareholder actually repays all or a part of the debt, the S corporation shareholder will be entitled to increase his or her amount at-risk by the amount of the payments when the S corporation shareholder no longer has a legal right to seek indemnification from the primary obligor on the loan (i.e. the S corporation or another shareholder). (Proposed Reg. Section 1.465-6(d))

An S corporation shareholder can increase his or her amount at-risk in S corporation if the shareholder borrows funds for with he is personally liable and then lends those funds to the S corporation. However, the S corporation's shareholder's amount at-risk in the corporation would be adjusted to reflect changes in the shareholder's basis in corporate indebtedness to the shareholder. (Proposed Reg Section 1.465-10(c) and (d))

10.7 PURCHASE OF STOCK

Under Proposed Reg. Section 1.465-22(d), the amount paid by a purchaser for an interest in an activity, such as stock in an S corporation, is treated as a contribution to the activity. Thus, where an S corporation shareholder purchases stock from an existing shareholder, the purchasing shareholder will be at-risk to the extent the purchase price (contribution) would increase the shareholder's at-risk amount. For example, if the stock were paid for in cash from the purchasing shareholder's personal funds, the at-risk amount would equal the purchase price of the stock. However, if the stock purchase were financed through a nonrecourse loan secured only by a pledge of the purchased stock, the purchasing shareholder's initial at-risk amount would be zero. (Proposed Reg. Section 1.465-25(b)) The rules for determining whether other property constitutes an interest in the activity are contained in Treas. Reg. Section 1.465-8.

10.7.1 Conversion from C Corporation to S Corporation Status

When a C corporation converts to an S corporation status, the shareholder's initial amount at-risk will be the shareholders adjusted basis in the corporation, determined by disregarding amounts described in IRC Section 465(b)(3) and (4). Presumably, a shareholder's adjusted cost basis in stock and loans made by such shareholder to the corporation as of the date of the conversion would be amounts at-risk for such shareholder. (Trea. Reg. Section 7.465-2(a))

10.8 ADJUSTMENTS TO AT-RISK AMOUNT

An S corporation shareholder's pro rata share of the S corporation's items of income, including tax-exempt income, will increase the shareholder's at-risk amount. (Proposed Reg.

Section 1.465-22(c)) In addition, gain recognized on the disposition of an activity or an interest in an activity will be treated as income from such activity. (Proposed Reg. Sections 1.465-12(a) and 1.465-66(a)) Also, a shareholder's at-risk amount will be increased by additional capital contributions of cash and property and for loans made by the shareholder to the S corporation, subject to the exceptions contained in IRC Sections 465(b), (IRC Section 465(b)(1) and Proposed Reg. Section1.465-10(c)) However, where there is an increase in a shareholder's at-risk amount immediately prior to the end of the S corporation's taxable year, which is followed by a corresponding decrease in such shareholder's at-risk amount shortly thereafter in the succeeding taxable year, such increase could potentially be disregarded depending on the fact and circumstances of each case (Proposed Reg. Section 1.465-4(a))

A shareholder's pro rata share of an S corporation's items of loss or deduction, including nondeductible expenses not properly chargeable to a capital account, will decrease the shareholder's at-risk amount, but only to the extent the loss or deduction would be allowed to the taxpayer under IRC Section 465(a). (Proposed Reg. Section 1.465-22(c)(2)) Also, an S corporation shareholder's at-risk amount will be reduced by distributions of money, whether in the form of a distribution made with respect to stock (out of the shareholder's stock basis or out of the accumulated adjustments account) or in the form of a loan repayment, to the extent of any decrease in the shareholder's adjusted basis in such indebtedness. (Proposed Reg. Section 1.465-22(b))

An S corporation's distribution of property other than money to a shareholder will decrease the shareholder's at-risk amounts in the activity in which the property was used. The decrease will equal the property's adjusted basis less any liabilities to which the property is subject for which the shareholder is not personally liable. The subsequent repayment of such liability by the taxpayer following the distribution will not increase the taxpayer's at-risk amount. (Proposed Reg. Section 1.465-23(c))

Where an S corporation shareholder has incurred recourse indebtedness and contributed or loaned the borrowed funds to his or her S corporation, Proposed Reg. Section 1.465-24(b) provides rules for determining the effect of the shareholder's loan repayments to the creditor on the taxpayer's at-risk amount. In general, loan repayments on a recourse loan will not increase the shareholder's amount at-risk. However, there are two situations where the repayments will decrease the shareholder's at-risk amount. First, where the S corporation shareholder uses assets that are already used in the activity, such as stock in the S corporation, to repay the recourse indebtedness, the S corporation shareholder's amount at-risk will decrease by the adjusted basis of the assets (as defined in Proposed Reg. Section 1.465-23(b)(1)). (See Proposed Reg. Section 1.465-24(b)(2)) Second, where the S corporation shareholder uses funds, which would not increase the S corporation shareholder's at-risk amount if contributed directly to the S corporation, to repay the recourse indebtedness, the S corporation shareholder's amount at-risk will be decreased by the amount of such funds. For example, where an S corporation shareholder repays a recourse loan with the proceeds of a nonrecourse loan secured by the S corporation shareholder's interest in the S corporation, the S corporation shareholder's amount at-risk will be decreased by the amount of the repayment.

Where an S corporation shareholder has incurred nonrecourse indebtedness and contributed or loaned the borrowed funds to his or her S corporation, Proposed Reg. Section 1.465-25(b)(2) provides rules for determining the effect of loan repayments.

In the case of nonrecourse loans, repayments may either increase or decrease the S corporation shareholder's amount at-risk depending upon two factors.

- The first factor is whether the nonrecourse loan increased the S corporation's shareholder's at-risk amount at the time it was incurred.
- The second factor is whether the funds or property used to make the repayment would increase the S corporation shareholder's amount at-risk if the funds or property were contributed directly to the S corporation.

If the S corporation shareholder's nonrecourse loan did not increase the S corporation shareholder's amount at-risk at the time it was incurred, subsequent repayments of the loan will result in an increase in the S corporation shareholder's amount at-risk. (Proposed Reg. Section 1.465-25(b)(2)(i)) However, if the amounts used to repay the nonrecourse indebtedness would not have increased the S corporation shareholder's amount at-risk if contributed directly to the S corporation, the S corporation shareholder's amount at-risk is unaffected by the repayment.

If the S corporation shareholder's nonrecourse loan did increase the S corporation shareholder's amount at-risk at the time it was incurred, subsequent repayments will not increase the S corporation shareholder's amount at-risk. However, if the amount used to repay this type of nonrecourse loan would not increase the S corporation shareholder's at-risk amount if contributed directly to the S corporation, the repayment will actually decrease the S corporation shareholder's at-risk amount.

If an S corporation shareholder's nonrecourse loan is converted to recourse, the S corporation shareholder's amount at-risk must be adjusted for the rules applicable to recourse indebtedness.

If an S corporation shareholder's recourse loan is converted to a nonrecourse loan, the S corporation shareholder's amount at-risk must be adjusted for the rules applicable to nonrecourse indebtedness. However, there are special rules for recourse loans, which become nonrecourse upon the happening of an event or a lapse of time (i.e. contingencies). Under such circumstances, the S corporation shareholder is only considered at-risk with regard to the loan while it was recourse if:

- There was a business purpose for incurring such indebtedness (determined by applying all of the facts and circumstances);
- The primary motivation for incurring the indebtedness was not the income tax consequences (also determined by applying all of the facts and circumstances); and
- The loan agreement is consistent with the normal commercial practice for financing the activity for which the money is being borrowed. (Proposed Reg. Section 1.465-5)

10.9 MULTIPLE ACTIVITIES - SEPARATELY COMPUTED & AGGREGATION RULES

10.9.1 Separate Computation

When an S corporation is engaged in multiple activities described in IRC Section 465(c)(1) and (3), the S corporation shareholder's at-risk amount must be separately computed for each activity. For example, if the S corporation is engaged in a film business and a subdivision of the S corporation is engaged in a farming business, the shareholders must determine his/her amount at risk for each activity. (IRC Sections 465(c)(2) and 465(c)(3)(B))

10.9.2 Aggregation Rules

In general, a taxpayer's activity with respect to each film or videotape, leased IRC §1245 property, farm, oil or gas property, or geothermal property is a separate activity. (IRC Section 465(c)(2)(A)) However, under IRC Section 465(c)(2)(B)(i), all activities with respect to IRC Section 1245 property that are leased or held for lease and placed in service in a particular taxable year of an S corporation may be aggregated as a single activity.

In addition, Temporary Treas. Reg. Section 1.465-1T permits S corporation shareholder's and S corporation's themselves to aggregate activities within each of the other four enumerated categories (motion picture film and videotape activities, farming activities, oil and gas activities, and geothermal activities) as a single activity if more than one activity within a single category are engaged in by the S corporation. However, except, as discussed below, different categories of activities within the five enumerated categories may not be aggregated as a single activity. For example, if an S corporation is engaged in the activity of exploring for, or exploiting, oil and gas resources with respect to 10 oil and gas properties, an S corporation shareholder may aggregate those properties and treat the aggregated oil and gas activities as a single activity. If that S corporation also is engaged in the activity of farming with respect to two farms, the shareholder may aggregate the farms and treat the aggregated farming activities as a single separate activity. Except as provided in Section 465(c)(2)(B)(ii), the shareholder cannot aggregate the farming activity with the oil and gas activity.

Under IRC Section 465(c)(3)(B), activities (other than the five enumerated IRC Section 465(c)(1) activities) that constitute a trade or business will be a single activity if the taxpayer actively participates in the management of such trade or business, or such trade or business is carried on by an S corporation and 65 percent or more of the losses for the taxable year are allocable to persons who actively participate in its management.

Thus, S corporation shareholders who actively participate in the S corporation's activities can always aggregate all of the activities that constitute a trade or business, and S corporation shareholders who do not actively participate in the S corporation's activities will still be able to aggregate such activities so long as the other shareholders satisfy the second test described above.

Active participation in management depends upon the facts and circumstances of each situation.

Factors that tend to indicate active participation include:

- Participating in the decisions involving the operation or management of the trade or business,
- Actually performing services for the trade or business, or
- Hiring and discharging employees (as compared to only the person who is in charge of the trade or business). (See H.R.Rep. No. 95-1445, 2d Sess., pp. 69 and 70 (1978).)

Factors that tend to indicate a lack of active participation include:

- Lack of control of management and operations of the trade or business,
- Having authority only to discharge the manager of the trade or business, and
- Having a manager of the trade or business who is an independent contractor rather than an employee. (See H.R.Rep. No. 95-1445, 2d Sess., pp. 69 and 70 (1978).) Thus, the sole action of hiring an independent contractor as the manager of an activity will not constitute active participation in the management of a trade or business.

10.10 DISPOSITION OF STOCK

An S corporation shareholder who has suspended losses, because of either an insufficient at-risk amount under IRC Section 465(a)(2) or the loss recapture rules under IRC Section 465(e), may be able to use such deductions upon the sale or other disposition of S corporation stock.

See Proposed Reg. Section 1.465-12(a) and Proposed Reg. Section 1.465-66(a) for the rules applicable to determining when gain on the sale of an activity or an interest in the activity will be treated as income from the activity.

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