

Section 469 and Gain Recognition Election Notice

Notice 2002-29

This notice explains the effect under § 469 of the Internal Revenue Code of a deemed sale of property on January 1, 2001, pursuant to an election under § 311(e) of the Taxpayer Relief Act of 1997 (TRA 97) (1997-4 (Vol. 1) C. B. 1, 49-50).

Section 1(h), as amended in 1997, provides for a reduced capital gains rate for qualified 5-year gain. Section 1(h)(2)(B)(ii) limits the amount of qualified 5-year gain to that determined by taking into account only property for which the holding period begins after December 31, 2000. Section 311(e) of TRA 97 provides that a noncorporate taxpayer may elect to treat a capital asset or property used in the trade or business (as defined in § 1231(b) of the Code) held by the taxpayer on January 1, 2001, as having been sold on January 1, 2001, for an

amount equal to its fair market value and as having been reacquired for an amount equal to its fair market value on the same date (mark-to-market election).

Section 469(g)(1)(A) provides that, if a taxpayer disposes of the taxpayer's entire interest in any passive activity (or former passive activity) in a fully taxable transaction that does not involve a disposition to a related party, then the excess of the loss from the activity for the taxable year (including any suspended passive activity loss) over any net income or gain for the taxable year from all other passive activities shall be treated as a loss which is not from a passive activity. As a result, if § 469(g)(1)(A) applies, the excess loss from the activity over any net income from all passive activities is no longer subject to the limitations of § 469.

A question has arisen whether electing a deemed sale of property under § 311(e) of TRA 97 is treated as a disposition of that property under § 469(g)(1)(A).

In a technical correction to § 311(e), § 414(a)(2) of the Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 21, clarifies that a mark-to-market election is not a disposition for purposes of § 469(g)(1)(A). Thus, the gain included in gross income by reason of a mark-to-market election may be passive activity gross income that can be offset by passive activity deductions, but the election does not otherwise affect the determination of the passive activity loss that is disallowed under § 469.

The principal author of this notice is Tara P. Volungis of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Volungis at (202) 622-3080 (not a toll-free call).