

Briefly, you can only deduct losses from a covered activity up to the amount you have “at risk” in that activity. Any excess losses aren't forfeited—they are carried forward and may be used in a later year when you obtain a sufficient amount at risk to cover it.

The amount you have at risk in an activity includes the cash and property you contribute to it. With respect to the contributed property, however, you count the basis you had in it, not its value. That is, if you contributed land with a basis (cost) of \$10,000 and a value of \$25,000, your at-risk amount will only be \$10,000, not the \$25,000 value.

You can also include borrowed amounts as amounts you have at-risk, but only if certain requirements are met. These rules are complex, but essentially they allow you to treat as at-risk amounts you borrow (a) for which you have personal liability, or (b) for which you have pledged property (other than property used in the activity) as security. In the case of pledged property, the at-risk amount is the fair market value of the property reduced by any superior claims against it. Additionally, you cannot include borrowed funds in your at-risk amount if the lender has an interest in the activity (other than as a creditor) or is related to someone with such an interest.

Unfortunately, these rules aren't the only ones that may limit your tax benefits from these investment losses. You may also be subject to rules limiting losses you may claim from “passive” activities. Additionally, if you hold your interest as a partner or S corporation shareholder, your losses may be limited to your basis in your interest under special rules applicable to partnerships and S corporations.