

whose securities the loss was sustained, the number of shares of stock or the number and denomination of debentures with respect to which the loss is claimed, the basis and selling price thereof, and the respective dates of purchase and sale of the securities, or the reason for their worthlessness and the approximate date thereof. For the rules applicable in determining the worthlessness of securities, see section 165 and the regulations thereunder.

[T.D. 7171, 37 FR 5621, Mar. 17, 1972]

**§ 1.1244(a)-1 Loss on small business stock treated as ordinary loss.**

(a) *In general.* Subject to certain conditions and limitations, section 1244 provides that a loss on the sale or exchange (including a transaction treated as a sale or exchange, such as worthlessness) of *section 1244 stock* which would otherwise be treated as a loss from the sale or exchange of a capital asset shall be treated as a loss from the sale or exchange of an asset which is not a capital asset (referred to in this section and §§ 1.1244(b)-1 to 1.1244(e)-1, inclusive, as an *ordinary loss*). Such a loss shall be allowed as a deduction from gross income in arriving at adjusted gross income. The requirements that must be satisfied in order that stock may be considered section 1244 stock are described in §§ 1.1244(c)-1 and 1.1244(c)-2. These requirements relate to the stock itself and the corporation issuing such stock. In addition, the taxpayer who claims an ordinary loss deduction pursuant to section 1244 must satisfy the requirements of paragraph (b) of this section.

(b) *Taxpayers entitled to ordinary loss.* The allowance of an ordinary loss deduction for a loss of section 1244 stock is permitted only to the following two classes of taxpayers:

(1) An individual sustaining the loss to whom the stock was issued by a small business corporation, or

(2) An individual who is a partner in a partnership at the time the partnership acquired the stock in an issuance from a small business corporation and whose distributive share of partnership items reflects the loss sustained by the partnership. The ordinary loss deduction is limited to the lesser of the partner's distributive share at the time of

the issuance of the stock or the partner's distributive share at the time the loss is sustained. In order to claim a deduction under section 1244 the individual, or the partnership, sustaining the loss must have continuously held the stock from the date of issuance. A corporation, trust, or estate is not entitled to ordinary loss treatment under section 1244 regardless of how the stock was acquired. An individual who acquires stock from a shareholder by purchase, gift, devise, or in any other manner is not entitled to an ordinary loss under section 1244 with respect to this stock.

Thus, ordinary loss treatment is not available to a partner to whom the stock is distributed by the partnership. Stock acquired through an investment banking firm, or other person, participating in the sale of an issue may qualify for ordinary loss treatment only if the stock is not first issued to the firm or person. Thus, for example, if the firm acts as a selling agent for the issuing corporation the stock may qualify. On the other hand, stock purchased by an investment firm and subsequently resold does not qualify as section 1244 stock in the hands of the person acquiring the stock from the firm.

(c) *Examples.* The provisions of paragraph (b) of this section may be illustrated by the following examples:

*Example 1.* A and B, both individuals, and C, a trust, are equal partners in a partnership to which a small business corporation issues section 1244 stock. The partnership sells the stock at a loss. A's and B's distributive share of the loss may be treated as an ordinary loss pursuant to section 1244, but C's distributive share of the loss may not be so treated.

*Example 2.* The facts are the same as in example (1) except that the section 1244 stock is distributed by the partnership to partner A and he subsequently sells the stock at a loss. Section 1244 is not applicable to the loss since A did not acquire the stock by issuance from the small business corporation.

[T.D. 6495, 25 FR 9675, Oct. 8, 1960, as amended by T.D. 7779, 46 FR 29467, June 2, 1981]

**§ 1.1244(b)-1 Annual limitation.**

(a) *In general.* Subsection (b) of section 1244 imposes a limitation on the aggregate amount of loss that for any

taxable year may be treated as an ordinary loss by a taxpayer by reason of that section. In the case of a partnership, the limitation is determined separately as to each partner. Any amount of loss in excess of the applicable limitation is treated as loss from the sale or exchange of a capital asset.

(b) *Amount of loss*—(1) *Taxable years beginning after December 31, 1978.* For any taxable year beginning after December 31, 1978, the maximum amount that may be treated as an ordinary loss under section 1244 is:

(i) \$50,000, or

(ii) \$100,000, if a husband and wife file a joint return under section 6013.

These limitations on the maximum amount of ordinary loss apply whether the loss or losses are sustained on pre-November 1978 stock (as defined in § 1.1244 (c)-1 (a)(1)), post-November 1978 stock (as defined in § 1.1244 (c)-1 (a)(2)), or on any combination of pre-November 1978 stock and post-November 1978 stock. The limitation referred to in (ii) applies to a joint return whether the loss or losses are sustained by one or both spouses.

(2) *Taxable years ending before November 6, 1978.* For any taxable year ending before November 6, 1978, the maximum amount that may be treated as an ordinary loss under section 1244 is:

(i) \$25,000 or

(ii) \$50,000, if a husband and wife file a joint return under section 6013.

The limitation referred to in (ii) applies to a joint return whether the loss or losses are sustained by one or both spouses.

(3) *Taxable years including November 6, 1978.* For a taxable year including November 6, 1978, the maximum amount that may be treated as ordinary loss under section 1244 is the sum of:

(i) The amount calculated by applying the limitations described in subparagraph (1) of this paragraph (b) to the amount of loss, if any, sustained during the taxable year on post-November 1978 stock, plus

(ii) The amount calculated by applying the limitations described in subparagraph (2) of this paragraph (b) to the amount of loss, if any, sustained during the taxable year on pre-November 1978 stock,

To the extent this sum does not exceed \$50,000, or, if a husband and wife file a joint return under section 6013 for the taxable year, \$100,000.

(4) *Examples.* The provisions of this section may be illustrated by the following examples:

*Example 1.* A, a married taxpayer who files a joint return for the taxable year ending December 31, 1977, sustains a \$50,000 loss qualifying under section 1244 on pre-November 1978 stock in Corporation X and an equal amount of loss qualifying under section 1244 on pre-November 1978 stock in Corporation Y. A is limited to \$50,000 of ordinary loss under paragraph (b)(2)(ii). The remaining \$50,000 of loss is treated as loss from the sale or exchange of a capital asset.

*Example 2.* For the taxable year ending December 31, 1979, B, a married taxpayer who files a joint return, sustains a \$90,000 loss on post-November 1978 stock in Corporation X. In the same taxable year, C, B's spouse, sustains a \$25,000 loss on post-November 1978 stock in Corporation Y. Both losses qualify under section 1244. B and C's ordinary loss is limited to \$100,000 under paragraph (b)(1)(ii). The remaining \$15,000 of loss is treated as loss from the sale or exchange of a capital asset.

*Example 3.* D, a married taxpayer who files a joint return and reports income on a fiscal year basis for the taxable year ending November 30, 1978, sustains a \$60,000 loss qualifying under section 1244 on pre-November 1978 stock and a \$40,000 loss qualifying under section 1244 on post-November 1978 stock. D's ordinary loss on pre-November 1978 stock is limited to \$50,000 under subparagraph (3)(i) of this paragraph (b). D's \$40,000 loss on post-November 1978 stock is within the limit of subparagraph (3)(i) of this paragraph (b). The total of these losses, \$90,000, is the aggregate amount deductible by D as ordinary loss under section 1244. The remaining \$10,000 of loss is treated as loss from the sale or exchange of a capital asset.

*Example 4.* E, a married taxpayer who files a joint return for the taxable year ending December 31, 1980, sustains a \$75,000 loss qualifying under section 1244 on pre-November 1978 stock and a \$10,000 loss qualifying under section 1244 on post-November 1978 stock. E may deduct the total of these losses, \$85,000, as ordinary loss under paragraph (b)(1)(ii).

*Example 5.* Assume the same facts as in the preceding example, except that the losses are sustained in the taxable year beginning January 1, 1978, and ending December 31, 1978. E is limited to \$60,000 of ordinary loss (\$50,000 on pre-November 1978 stock plus \$10,000 on post-November 1978 stock) under paragraph (b)(3). The remaining \$25,000 of loss is treated

as loss from the sale or exchange of a capital asset.

*Example 6.* F, a married taxpayer who files a joint return for the taxable year beginning January 1, 1978, and ending December 31, 1978, sustains a \$75,000 loss qualifying under section 1244 on pre-November 1978 stock and a \$125,000 loss qualifying under section 1244 on post-November 1978 stock. F's loss on pre-November 1978 stock is limited to \$50,000 of ordinary loss under subparagraph (3)(ii) of this paragraph (b). F's loss on post-November 1978 stock is limited to \$100,000 of ordinary loss under subparagraph (3)(i) of this paragraph (b). The total of these losses, \$150,000, is limited to \$100,000 of ordinary loss under paragraph (b)(3). F's aggregate amount of ordinary loss under section 1244 is \$100,000. The remaining \$100,000 of loss is treated as loss from the sale or exchange of a capital asset.

[T.D. 7779, 46 FR 29467, June 2, 1981]

**§ 1.1244(c)-1 Section 1244 stock defined.**

(a) *In general.* For purposes of §§ 1.1244(a)-1 to 1.1244(e)-1, inclusive:

(1) The term *pre-November 1978 stock* means stock issued after June 30, 1958, and on or before November 6, 1978.

(2) The term *post-November 1978 stock* means stock issued after November 6, 1978.

In order that stock may qualify as section 1244 stock, the requirements described in paragraphs (b) through (e) of this section must be satisfied. In addition, the requirements of paragraph (f) of this section must be satisfied in the case of pre-November 1978 stock. Whether these requirements have been met is determined at the time the stock is issued, except for the requirement in paragraph (e) of this section. Whether the requirement in paragraph (e) of this section, relating to gross receipts of the corporation, has been satisfied is determined at the time a loss is sustained. Therefore, at the time of issuance it cannot be said with certainty that stock will qualify for the benefits of section 1244.

(b) *Common stock.* Only common stock, either voting or nonvoting, in a domestic corporation may qualify as section 1244 stock. For purposes of section 1244, neither securities of the corporation convertible into common stock nor common stock convertible into other securities of the corporation are treated as common stock. An increase in the basis of outstanding stock as a result of a contribution to capital is not treated as an issuance of stock under section 1244. For definition of do-

mestic corporation, see section 7701(a)(4) and the regulations under that section.

(c) *Small business corporation.* At the time the stock is issued (or, in the case of pre-November 1978 stock, at the time of adoption of the plan described in paragraph (f)(1) of this section) the corporation must be a *small business corporation*. See § 1.1244(c)-2 for the definition of a small business corporation.

(d) *Issued for money or other property.* (1) The stock must be issued to the taxpayer for money or other property transferred by the taxpayer to the corporation. However, stock issued in exchange for stock or securities, including stock or securities of the issuing corporation, cannot qualify as section 1244 stock, except as provided in § 1.1244(d)-3, relating to certain cases where stock is issued in exchange for section 1244 stock. Stock issued for services rendered or to be rendered to, or for the benefit of, the issuing corporation does not qualify as section 1244 stock. Stock issued in consideration for cancellation of indebtedness of the corporation shall be considered issued in exchange for money or other property unless such indebtedness is evidenced by a security, or arises out of the performance of personal services.

(2) The following examples illustrate situations where stock fails to qualify as section 1244 stock as a result of the rules in subparagraph (1) of this paragraph:

*Example 1.* A taxpayer owns stock of Corporation X issued to him prior to July 1, 1958. Under a plan adopted in 1977, he exchanges his stock for a new issuance of stock of Corporation X. The stock received by the taxpayer in the exchange may not qualify as section 1244 stock even if the corporation has adopted a valid plan and is a small business corporation.

*Example 2.* A taxpayer owns stock in Corporation X. Corporation X merges into Corporation Y. In exchange for his stock, Corporation Y issues shares of its stock to the taxpayer. The stock in Corporation Y does not qualify as section 1244 stock even if the stock exchanged by the taxpayer did qualify.

*Example 3.* Corporation X transfers part of its business assets to Corporation Y, a new corporation, and all of the stock of Corporation Y is issued directly to the shareholders of Corporation X. Since the Corporation Y stock was not issued to the shareholders for